

FUNDAMENTALS
OF
ACCOUNTING

KOOPMAN-KESTER



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FUNDAMENTALS OF ACCOUNTING

Principles and Practice of Bookkeeping

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IN TWO VOLUMES

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PREFACE

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THIS work represents an endeavor to provide suitable text material covering the basic principles of accounting and book-keeping practice in convenient form for instruction by the class method. It is the result of years of experience both in the classroom and in business and its methods have brought uniformly good results.

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The material here presented is designed as a one-year course for students beginning the subject. Since a student's use of the general principles of accounting depends on his ability to apply them intelligently, his basic training is of vital importance. His first steps must be taken with care. In this treatise the correct point of view is held constantly before him, the subject being developed logically and easily in a well-graded course. Ample drill material is provided at the end of each chapter in the form of carefully graded problems to fix the principles treated. Not all the problems in every chapter may be required for every class. It is suggested that the teacher proceed with the new chapter as soon as the pupils can apply the principles discussed.

A second book is in course of preparation and will be ready within a year. The two books will present the materials usually covered in high school courses.

This text had its inception in the course, Methods of Teaching Bookkeeping and Accounting, given since 1916 to public and private secondary school teachers in the summer session at Columbia University. It forms the basis for the work in the Theodore Roosevelt High School where the members of the teaching staff have tested it out successfully and have secured excellent results.

The authors desire to express their appreciation of the assistance rendered by Miss Edith Fremdling and Mr. John Jaffe in the preparation of part of the practice material. They are under obligation, also, to the many business houses and banks that extended every courtesy in the use of business forms in this text.

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NEW YORK CITY,
October 15, 1921.

INTRODUCTORY

In a current survey of commercial education in the public high schools of the United States it is stated that the commercial course is a "technical training course giving instruction in mechanical routing"; that it is an "inheritance from the business college"; that it is an "attachment, not a coalescence to the old high school"; and finally that it is "utilitarian, not social" in its aims and ideals. Only within a very few years has there been even a partial appreciation of the real status of commercial education in the public high schools. This indictment applies in full to bookkeeping, which has always formed the backbone of the commercial course. The teaching of bookkeeping has been seriously handicapped not only by the difficulty of securing professionally trained teachers but by the lack of text material organized to develop fundamental principles through reasoning.

A recent syllabus in bookkeeping gives the aims of the course as four, viz.:

1. To develop the fundamentals of accounting.
2. To teach the art of bookkeeping.
3. To give instruction concerning business practice.
4. To develop the mind, particularly the analytical and imaginative abilities.

The authors of this text are in agreement with these aims, but prefer to state the purpose of bookkeeping instruction as the development of mental capacity by means of, and in relation to, the first three aims above tabulated. So-called education that does not stimulate the student to the free use of his mental equipment is spurious, and its inclusion is a criminal waste to be condoned only on the ground of ignorance, never on the ground of expediency.

Heretofore bookkeeping has been studied primarily to fit the student to record information which the business man has found useful in conducting his business, the bookkeeper being a mere recorder or mechanical operator who acquires skill and accuracy by recording, day after day, information of the same type. Small wonder, then, that bookkeeping has been called a "blind alley job," that it has been referred to as monotonous, deadening, mechanical work with but slight chances of promotion! Small wonder, then, that it is said to have little educational value!

The trouble is not in the subject matter, but in the manner of its presentation. The mechanical side has been emphasized as the great aim of the subject. Accordingly, those whose minds ran to order, neatness, carefulness, and detail were quite successful through following the rules provided by some mechanical recorder. But the successful bookkeeper usually remained a bookkeeper all his life, while a person who studied bookkeeping but did not practice it obtained practically no benefit from his study except a knowledge of business customs picked up incidentally.

A great deal of attention has been given to penmanship and arithmetic as aids in correctly gathering business data. They, however, only obscure the real educational value of bookkeeping when taught during the bookkeeping recitation and can be taught much more effectively as separate subjects. One never thinks of placing any emphasis on penmanship in teaching story-writing—the means of recording is always secondary. Just as we expect the student to write a legible hand, so we expect him to know elementary arithmetic, including simple percentage and interest calculations.

The value of bookkeeping training must be judged from two standpoints—educational and vocational. It is doubtful whether any subject can be allowed a place in the school curriculum solely on a vocational basis. It must also possess educational value in large measure. If properly presented, bookkeeping has a distinct educational value, and will develop the student's

reasoning powers in regard to business affairs, because bookkeeping is applied economics. It is vocational only because of its subject matter. It is intensely practical, but that, instead of detracting from its educational value, should largely increase it because of the element of interest involved. This interest is too often killed by the mechanical methods used in teaching the subject. Not the recording, but the effect of a business transaction on the financial affairs of a business should be emphasized. The record-making, while important, is only incidental. The real educational value of bookkeeping comes from the development of the student's ability to form correct judgments as to the financial effect of the operations of a business unit. This, the management viewpoint, is the important thing for the student's future growth. The student no longer looks to the collecting of information as an end in itself, but only as a means of directing the operation of the business more effectively. His viewpoint is larger; it is that of the manager or executive instead of the recorder or bookkeeper.

What, then, is the best method of presenting the subject to secure the desired results? Psychologists maintain that a person works more intelligently and with greater interest if he knows the goal toward which he is headed, i. e., the mind forms a better concept of the new thing by studying it as a unit first, then separating it into its parts, studying each part in its relation to the whole, and finally building up the whole from its parts. This method proceeds from the general to the particular and then from the particular to the general. By this method a general rule is deduced which the student uses in determining the relation of the parts to the whole.

Not the mechanical or the logical order, but the psychological order of presenting the subject should be followed. The material is arranged in such order that the mind can grasp the new concept most easily and interpret (apperceive) it most completely in terms of related concepts already in the mind. In teaching, old related material should be recalled before the new matter is

presented. It is generally understood that only one new thing should be presented at a time. The new thing should then be associated as closely as possible with the old related material, after which should follow a generalization or summary for the purpose of placing the particular item in a general class. This generalization or summary often takes the form of a rule or principle. Finally the new concept should be fixed in mind by means of application or drill.

The Equation Method used in this text is an attempt to present the fundamentals of accounting in psychological order. This method emphasizes the organization and management viewpoint, stressing the effect of business transactions rather than aiming at mechanical dexterity in recording them.

The personal possessions and debts of the student are taken as the foundation upon which to lay proper concepts of things owned (assets) and things owed (liabilities). The student is personally interested in these, and therefore grasps their new relation more easily than if the approach were in connection with things of others. When the student once knows how to determine his own financial condition, he can easily apply the same principles to the financial condition of business enterprises. According to this plan, the small business of an individual owner is considered and his proprietorship interest is measured by means of the basic equation: Assets minus liabilities equals capital. A statement of his financial condition as of a later date is then prepared.

A comparison of his proprietorship as of the two dates will show that a change has occurred. Realization that the causes of such changes are not apparent leads naturally to inquiry for other data that will give causes. To obtain this additional information comprising the income and expenses of business operation, records must be kept. The most complete and satisfactory record consists of double-entry books of account, which contain all changes in assets and liabilities and so provide the desired information concerning income and expenses. The process thus

naturally works back to the ledger which furnishes this classified information, after which the journals or books of original entry are introduced as devices for collecting the desired information. Thus at every step the goal is in sight and the relation of the new devices introduced to the fundamental equation is easily discernible. This is accomplished through the constant insistence that each transaction be explained in terms of assets, liabilities, and proprietorship. The student thus obtains a comprehensive knowledge of the accounting procedures required for a small, simple business unit during an accounting period. Since all succeeding work consists merely of more complex applications of the same principle, the student can easily understand the new work. There is continuous interest because new items—classes of assets and liabilities and subdivisions of proprietorship—are being added one at a time. The student's attention is everywhere directed toward the economic rather than the mechanical aspect of the subject.

Depending on the amount of study devoted to the subject the student will acquire such a knowledge of business data and the ability to record and interpret them as will enable him to act as a bookkeeper or office assistant. Since the great majority of those entering business, however, either never become bookkeepers or do not continue as bookkeepers, the emphasis in teaching should be placed on the general grasp of financial problems, rather than upon mechanical recording. Principles must, however, always be given ample application before the process of teaching is complete. Some practical applications of accounting can be taught without teaching accounting, but the student secures only a one-sided view and is therefore likely to make wrong judgments. He does not know how the operations which have taken place in the various departments of the business have produced the figures found in the different financial statements. Therefore the subject cannot be taught effectively by eliminating all mechanical recording.

Principles without practice are vain. Practice based on

rule-of-thumb and not on logical principles can never be sure of itself. The authors have, therefore, attempted to develop a textbook for the beginner based on a proper balance between these two essential elements. To supply a text providing instruction from the standpoint of a class recitation rather than a mere laboratory exercise has been an aim kept constantly in view. The laboratory method is a holdover from the time of the apprentice system when one could learn only by doing. It is narrowing, wasteful, and non-educational, and can be defended only where the instruction material has not been sufficiently organized for proper presentation in the classroom. The method of the class recitation comprising a simple and psychological development and discussion of basic principles together with a careful application of them should be used in teaching bookkeeping just as in teaching mathematics, science, or language. Plenty of practice problems should be required of the student to make sure of his grasp of principles. The student is therefore given home or study assignments both of text matter and of practice problems.

The authors believe that teachers of bookkeeping all over the country are awakening to the needs of the situation and are equipping themselves for better service by home and continuation study in schools of commerce.

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FUNDAMENTALS OF ACCOUNTING

CHAPTER I

WHY STUDY ACCOUNTING?

Education as a Preparation for Life.—In our country, where every boy and girl is familiar with the system of public education, it may seem hardly necessary to state that the purpose of education is to prepare one for his life's work. From the beginning of our country's existence one of her chief aims has been the education of her youth. Almost all states have compulsory education laws in accordance with which a boy or girl must continue in school until he has attained a certain age or a certain grade in his school work. When one compares men in various walks of life, one cannot help noting that a very large percentage of the successful men in a community are educated men.

Of the boys and girls who finish the eighth grade, not more than 20% finish the high school course; and of those who finish high school only a very small percentage finish a course in college. While we have notable examples of men deemed successful in life who have not had a college education, yet it is recognized that in our present-day civilization an educated man has a much better chance of success than a man without education.

As to what constitutes a successful life, opinion of course differs. One man may set for himself the acquiring of a large fortune. If he falls short of his goal, he will not consider himself successful. Another man may set for himself perfection in music or painting. Unless he attains the standard of perfection set for himself, he will not consider himself successful, although by others he may be proclaimed an artist. Success is often measured in terms of happiness. Ethical values are often considered the

measure of success. It is frequently said that a man who has given the most of himself to the community, that is, to the civilization in which he lives, gets the most of real satisfaction out of life. Certainly, when measured by this standard of success, education is a necessary preparation for a successful life.

In its broader sense education should not be limited to the training acquired in the schoolroom, but should be looked upon as a continuous process. The habits of thought and the training that one acquires in the classroom should be carried into everything done after the formal school life is over. When so viewed everything a man does may be used for educative purposes. Unless education is something more than a cloak to be put on or laid aside at will, there is little of permanent value in it.

The fundamental purpose in education is to teach the learner how to use his mental abilities in making the most of the life and civilization in which his lot is cast. Development of any sort, be it of muscle or of mind, can come only from use. The start which one acquires in school should be looked upon simply as a start. Habits are formed and methods of using one's abilities are acquired which, unless developed through daily use, will soon become of no value. What particular place one may fill in the life of one's community is always a most important question and one which faces every boy and girl of high school age. It is proposed in this first chapter to point out some of the kinds of work which may prove attractive to high school students.

Vocations as Forms of Service.—In the earlier history of the human race it is supposed that every man, or at least every family, was more or less self-supporting and self-sufficient. Each family made all of the things necessary to secure the best kind of a living possible in those days. Building a house for shelter, making clothing, getting food—all these were done by each family for itself. As civilization advanced and men became more dependent on one another, divisions of labor developed. In this way one group of men did certain things for which they were best fitted,

and furnished certain necessities to their fellow-men, who in turn did other things for which they were best fitted, and so furnished some of the other necessities of life. Thus the many duties and tasks which have to be performed to make living satisfactory were divided and men began to specialize, that is, they limited themselves to one kind of work instead of trying to do all kinds. In this sense, then, a man's work or his vocation may be said to consist in or arise from the services which society has to have performed.

Choosing a Vocation Early.—Because of the way in which society is constituted at the present time, boys and girls growing up into manhood and womanhood must prepare to take their places in the various vocations of life. Which vocation will be best for each is the greatest problem that faces any boy or girl. It is, indeed, a very unhappy situation to find yourself, like a square peg in a round hole, unfitted for the task confronting you. Happy is the youth who can settle early in life the position or vocation he desires to enter and can then train himself definitely with that end in view. There is always a waste of effort and loss of time in changing about from one thing to another until one at last finds the particular vocation for which he thinks himself best fitted. We shall try now to give the student an idea of the main vocations or kinds of service which life today requires to be performed.

Classification of Vocations.—Vocations may be broadly divided into two groups, public and private.

I Public Group

1. **Government Service.** Under this head are found three major kinds of services:

- (a) **Legislative**, which concerns itself with law-making.
- (b) **Judicial**, which concerns itself with the interpretation and meaning of the laws.
- (c) **Executive**, which concerns itself with the carrying out of the laws. Under each of these branches of government service there are many bureaus and departments. The Post-Office

Department, the Farm Bureau, the Interstate Commerce Commission with its many activities, the Federal Trade Commission, and the Consular Service are examples of the many different kinds of governmental service.

2. Religious Service. This includes services which the church and allied societies perform.
3. Educational Service. This includes both public and private schools and all formal educational activities wherever found, such as employees' training classes in banks and other corporations, government bureaus, etc.

II Private Group

1. The Professions, under which are included the vocations of medicine, teaching, law, accounting, engineering, dentistry, journalism, chemistry, etc.
2. The Non-Professional Vocations, which comprise all of those generally spoken of as business.

It is not possible to indicate at this time the many positions which are found under each one of these classes or subclasses. Every boy and girl knows what a good many of these are, and many a student is training specifically for some one of them.

How important the commercial occupations are, as distinguished from industrial or manufacturing occupations, is seen from the following quotation from Bulletin No. 34, issued by the Federal Board for Vocational Education:

More young people between the ages of 14 and 16 years are employed in commercial occupations than in industrial pursuits. A recent survey of such workers in an eastern city of about 300,000 population revealed the fact that out of 2,750 boys and girls included, only 300 were in occupations which, by the widest stretch of the imagination, could be classified as industrial. The remaining 2,450 were recorded as commercial employees.

With a knowledge of the whole field of vocations, it should be possible to choose one which seems most attractive and for which the student thinks himself best fitted.

Private Ownership of Property.—In whatever vocation one's lot may be cast it will always be found that the private ownership

of property is an unquestioned right of the individual. Proprietorship, that is, the ownership of property, is looked upon as a very desirable thing. Men strive for property, not so much for its own sake, but because of the many satisfactions which the ownership of property gives to them. In the ownership of property it is necessary to keep a record of the kinds and amounts of property owned. In order to do this it is necessary to place a money value on them. Thus the amount of one's property is more easily kept track of. All businesses are concerned with the ownership of property.

In the acquisition and control of property, proper management is necessary. The ways in which businesses are organized into single proprietorships, partnerships, and corporations, and also into departments and subdepartments for the more efficient handling of the work to be done must be studied carefully by the business man if he expects to bring his undertaking to a successful issue. In every enterprise provision must be made for gathering information about the business, for analyzing and organizing it, and finally for using it in the administration of the business. Unless a business man has reliable information about the many details of his business, he cannot hope to manage it efficiently.

Place of Accounting in Business.—It is in this connection that accounting has a place in business. It provides a simple method for getting information and for analyzing and organizing it. The information furnished by the accounting records shows the relation of each department and of each activity to the business as a whole and to each of the other departments. The accountant by watching his records can almost see the business grow under his fingertips as he makes the record. If he is wide-awake and really understands what he is doing, he can gain a complete understanding of the way in which the business is organized, the relations of one department to another, and can gain a concept of the problems of business management. Accounting may be said to make a record of the pulse of the business

and, therefore, to indicate its condition as to health or sickness. It is apparent, therefore, how important the accounting records are in any business.

Educational Value of Accounting.—It has been said that commercial subjects have little real educational value, that they are more in the nature of manual training subjects than of those which give mental discipline. This early impression of the value of commercial training has been largely discarded. It is now fully realized that the problems which arise in business require for their solution as high a type of mental discipline and training as the problems met in any other activity. It follows, therefore, that the study of business subjects and business problems will give as good a mental discipline as will the “hypothetical” problems of the classical education.

Reasoning power is developed through practice in the formation of correct judgments in business affairs and through analysis of a given set of facts to show the relation of one part to another. All phases of mental discipline are found in the study of business subjects and to a marked degree in the study of accounting. There is, however, always the danger that the mechanical operations involved in making the record in the books of account may be emphasized rather than the fundamental principles in accordance with which the records must be made. If the underlying principles are first studied and then put into practice by means of drill work, the subject of accounting can be made to rank high as to educational value. Principles for their own sake have little value; but when put to use in solving the practical problems of every-day business, principles have a large measure of value.

Vocational Value of Accounting.—Accounting has come to be one of the best of the younger professions. There are two divisions, one devoting itself to public, the other to private practice.

The public accountant is called in for consultation and advice by men in all kinds of business. He has an office and a staff of assistants just as has the lawyer. Accounting firms are composed usually of partners who are the owners of the business. Under them are supervising seniors who supervise the work being done for the various clients. The supervising senior, who may be in charge of a number of jobs or assignments at the same time, has under his direction the senior accountants, who are each actively in charge of an individual assignment. The senior will have as his assistants men known as "semiseniors" and "juniors." A young man entering the accounting profession may expect to pass through the varying grades of accountants, junior, semi-senior, senior, and supervising senior, and may look forward after a thorough training in the practical phases of the work to being the proprietor of his own accounting business.

The private accountant gives his entire time to one business. There are many grades of bookkeepers and accountants in most businesses. The larger the business, the greater the subdivision of duties, some requiring very little knowledge of accounting for the proper performance of the task. It is this sort of position, known as a "blind-alley job," into which the person who knows only the mechanical side of bookkeeping usually falls. Only by means of a mastery of the fundamental principles of accounting and through a knowledge of business practice in general can an employee hope to avoid this kind of job, or work out of it if he finds himself in it. The higher positions—head bookkeeper, head accountant, auditor, manager, comptroller, secretary, or treasurer—all require a broad knowledge not only of accounting but also of the allied subjects, economics, business organization, banking, and law.

Value of Accounting to the Business Man.—For the man who does not expect to follow accounting professionally a fundamental knowledge of the subject is extremely valuable in the conduct of his business. As stated before, business cannot be conducted

today on any other basis than a complete knowledge of all of its activities. This is furnished largely by the accounting records. Unless, therefore, the business man knows how the accounts can be made to give this information, he is greatly handicapped in knowing what to expect from his accounting department and in making sure that he gets all the assistance and information to which he is entitled.

Scope of This Course in Accounting.—The student will want to know what he may expect to learn from this first course in the fundamentals of accounting. As the title indicates, it covers the fundamentals and some of their applications. Any training which is worth while in the business life of the community must of necessity be severe and of long duration. It is not possible, therefore, in a brief one year's course, to cover more than the barest fundamentals. On a foundation which has been securely laid, however, a solid superstructure may be built. It is the purpose, therefore, of this course to lay a good foundation. The student who really desires a complete mastery of the subject will not be content with anything less than a full understanding of the foundations on which he expects to rest his training for a life-work. It may be said that at the close of the first year's work he should be able to keep a simple set of books. From the way in which the subject is presented, he will have a much surer foundation and will be better able to handle the ordinary problems of the bookkeeper than one who has been trained by the usual methods. This results from the fact that he is taught to think about the problems that arise in the keeping of records and in the management of business. He is led to see the proper solution of these problems. The emphasis is never placed upon the mechanical operation of keeping the record, but always on the principles underlying the record, and on the judgments which must be made in determining the kind of record and the way in which it must be kept. It is in this feature of the work that its real educational and practical value lies.

QUESTIONS

1. What is the basic purpose of education?
2. Why are compulsory education laws in force in most states?
3. Has the educated man a better chance of success than the uneducated or partly educated man? Why?
4. About what percentage of pupils completing the eighth grade enter high schools? Why?
5. About what percentage of pupils entering high school complete the four-year high school course?
6. Give some reasons for the failure of pupils to complete a high school course.
7. What constitutes a successful life?
8. Name five different kinds of success in which gaining great wealth is not a part.
9. In what way does rendering service play a part in making for success?
10. Explain how habits of thought formed in school can be applied after leaving school.
11. What is a vocation?
12. What caused the vocations to increase in number?
13. What is meant when a person is spoken of as a "square peg in a round hole?"
14. What are the two broad groups of vocations?
15. (a) Name the three subgroups under public service.
(b) Explain each of the three subgroups.
16. What are the two subgroups under private services?
17. What is a profession?
18. What are non-professional vocations? Name five.
19. Why do men strive for property?
20. Why does the business man make provision for gathering, analyzing, and organizing information about his business?
21. What place has accounting in business?
22. What educational value has the study of accounting?
23. In what way is reasoning power developed through a study of accounting?
24. Distinguish between public and private accounting.
25. Name the various grades of positions: (a) in public accounting; (b) in private accounting.
26. What is a blind-alley job?
27. Why is a knowledge of fundamental principles of accounting of more importance than a knowledge of merely the mechanical side of bookkeeping?

28. Of what value is a knowledge of accounting to the business man?
29. Which of the following courses is more likely to lead to success and why:
- (a) A course in which principles are developed and then applied?
 - (b) A course in which only the mechanical recording of information is taught?

PROBLEMS

1. Write a statement of not more than 200 words giving your reasons for taking this course.
2. Make a survey of your immediate neighborhood (three or four blocks in a large city or the entire business section in a small town) and prepare a list of the various kinds of business carried on.
3. Visit some business house and prepare a detailed list of the different jobs or positions within that business.
4. Prepare a list of not more than five vocations in which you are interested, arranging them in the order of their importance to you. In each case give the reason for your choice.
5. Prepare a tabulated list of the things you think a proprietor should know about his business in order to manage it efficiently.

CHAPTER II

BUSINESS, ACCOUNTING, AND PROPRIETORSHIP

Purpose of Chapter.—

1. Meaning of the terms:
 - (a) Things owned.
 - (b) Things owed.
 - (c) Net worth.
2. Use and application of the bar graph.

Business.—In its broad sense the term “business” means that effort which one puts forth to increase his wealth or property. In its narrow sense it is frequently understood to mean only the buying and selling of goods. However, one may also buy and sell services. Therefore business, as considered in this text, will include the purchase and sale of both goods and services.

Business Classified.—Business is frequently classified in accordance with the fundamental industries as follows:

1. Extractive—mining, farming, lumbering, etc.
2. Manufacturing—the combining of various articles, called “raw materials,” into a new article, as the assembling of an automobile; or in changing the form of an article, as when logs are cut into boards. The finished article of one manufacturing concern may furnish the raw material of another concern. The finished product of the sawmill (lumber) is the raw material of the furniture factory. Yet both are manufacturing concerns.
3. Trading—buying and selling goods.
4. Service—the furnishing of facilities, conveniences, or personal services to the conduct of the other three groups.

Each of these large divisions may be subdivided. For example, under the extractive group, mining may be divided into coal, iron, copper, gold mining, etc., and under the manufacturing group is the making of automobiles, furniture, farm implements, machinery, etc. Under the service group are transportation, personal service, and miscellaneous. Transportation may be subdivided into rail, water, and air, each of which may be further subdivided into passenger, freight, etc. Personal service includes such vocations as the law, engineering, accounting, etc. Under the miscellaneous division may be mentioned banking, brokerage, and the insurance, telephone, telegraph, and hotel businesses, etc.

Under the trading group comes the distribution of shoes, jewelry, groceries, etc. In this group the things are generally sold in the form in which they are purchased. Some articles, however, are purchased in large quantities and sold in small quantities, as sugar purchased by the barrel and sold by the pound. A common classification of *trading* is wholesale and retail, depending on the quantities sold. The wholesaler handles articles in large quantities, such as dozens, gross, boxes, barrels, bags, etc., and distributes to other dealers (retailers), who sell in small quantities to the consumer. The small dry-goods, hardware, drug, and grocery stores, etc., are engaged in the retail business. Not all retail dealers operate small stores, however. Witness the huge department stores in every large city, such as John Wanamaker in New York and Philadelphia, B. Altman and Company, Lord and Taylor, and others in New York, Marshall Field and Company in Chicago, and Jordan Marsh Company in Boston. These are really groups of several stores under one roof, each department constituting a store in itself.

Accounting.—Accounting consists of gathering and presenting information concerning the money values of the things used in business, the debts owed to others, and the proprietor's net worth. It grows out of commerce or the exchange of things.

Uncivilized people do not need a system of accounting because they have little or no property and what little they have is exchanged directly by means of barter, without the use of money. Illustrations of barter are the exchange of a bushel of potatoes for a gallon of maple syrup and the exchange of several sheep for a horse. In a civilized community almost every person owns property of some kind. Many people also have debts, that is, they owe others for things purchased for which full payment has not been made. In business the buying and selling of commodities results in the incurring of new debts and the payment of old debts, causing changes in things owned and things owed.

In installing an accounting system for an individual or group of individuals, the facts that must be known are **things owned**, **things owed** (some of the things owned may not have been paid for) and the **net worth** or difference between the things owned and the things owed.

Things Owned.—Practically everything which has value may be spoken of as property or things owned. Examples are shoes, clothes, skates, bicycles, books, money, toys, pictures, musical instruments, money owed to one by a friend, fountain pens, watches, rings, cameras, automobiles, land and buildings, etc.

To find the *money value* of things owned we estimate what each article is worth in money and then find the total value. This may not be the correct amount available for business purposes because we may have included things having a sentimental value and things necessary for personal use.

Things Owned Having a Sentimental Value. Among the things owned there might be a photograph of a dear friend or relative. One might not want to part with it for \$100; but to someone else it might have no value. This shows that the article has a sentimental or personal value but no business value; therefore it must not be included in any list of things owned for business purposes.

Things Owned Necessary for Personal Use. Every individual needs some things for personal use, such as clothes, shoes, jewelry, etc. One person might want many things, such as furniture, automobile, horses and carriages, a house, etc., for personal use, while another might prefer to use his money for business purposes.

Things Owned Used for Business Purposes. If one omits all things having a sentimental value and those considered necessary for personal use, the things that remain can be used for any other purpose. They might be given away or sold and the money obtained from their sale used to buy other things that people want (things easily sold). These things in turn might be sold to others for more than the price paid for them. It has been shown above that this buying and selling of things is one type of business—trading.

Things Owed.—All of the things owned for business purposes are not always fully available for such use because there may be debts which will have to be paid in money or its equivalent. These may arise in various ways. There are two types of things owed—one payable in money, the other not payable in money. One may owe a duty to his parents or to the government or to a friend for a social call or for an engagement to be a guest. These are things owed, but they are not payable in money. The following are illustrations of things owed (debts) that *are* payable in money:

1. Suppose your bicycle met with an accident and you have not yet paid Robert Allen, the repair man, \$7 for repairing it. Among your *things owed* would be, "Robert Allen for repairs to bicycle, \$7."

2. Charles Robinson bought a violin for \$50. He paid \$5 at the time of purchase and agreed to pay \$1 per week until the violin is paid for. Suppose he has paid all except the last ten instalments, then among his *things owed* would be, "Unpaid instalments on violin owed to H. Smith, \$10."

3. Arthur Hill buys \$4 in groceries from the Modern Grocery

Company, promising to pay next week. Among Arthur Hill's *things owed* would be, "Bill of Modern Grocery Company, \$4."

Things owed are usually listed by stating the name of the person or persons owed and the amount in money.

Net Worth.—In answer to the question "How much are you worth?" one might say, "All I can earn, \$10 a day"; another might answer, "\$50," thinking of the amount of money in his pocket; and still another might say, "I am worth \$6,000," having in mind the total money value of all the things he owns but not considering the amount of his debts payable in money. One frequently hears, "So-and-so is worth a million dollars," and many are vaguely aware that this person must own a lot of things, but not everyone knows how to find this worth.

To get a clear idea of "worth" or "net worth" as used in accounting, we must use the two terms just explained—things owned and things owed. Net worth is obtained by deducting the total money value of *things owed* from the total money value of *things owned*; the difference measures the **amount of net worth**. As used in business, then, "net worth" represents the owner's or proprietor's investment or equity in the total *things owned* which are used in a given business enterprise. It shows the money value of the things owned which the proprietor has furnished, while the title "things owed" shows the money value of the things provided by others.

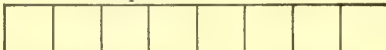
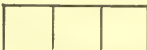
Title of the Statement.—The statement showing things owned, things owed, and net worth, must be given a definite date and should contain the name of the proprietor or owner of the things. Generally the heading will contain: (1) the name of the owner, (2) what the statement contains, and (3) the date, arranged in three lines and centered.

The title, Statement of Financial Condition, or Statement of Things Owned, Things Owed, and Net Worth, may be given to this statement.

Elementary Graphs.—A graph is a form of writing or device that appeals to the eye. When used in connection with figures in a report, graphs serve the same purpose as illustrations in books and newspapers—to attract attention and aid in telling the story. One of the simplest forms for stating facts graphically is the bar graph or diagram. This is a heavy line  (bar) extended horizontally or placed vertically on a base line . The parts of the bar that represent the different divisions of the whole are shown in different colors or shaded differently (cross-hatched).



The following condensed statement of things owned, things owed, and net worth arranged in graphic form indicates how use of the bar diagram can be made in the present work. Use different colors for each group if desired.

Tabulated		Graphic
Things owned	\$80	
Minus Things owed	50	
Equals Net worth	30	

Scale: Every quarter inch ($\frac{1}{4}$ in.) in the length of the bar represents a unit of \$10 in money value.

Illustration

PROBLEM: Henry Thompson has just graduated from high school and has been informed that there is an opportunity to purchase the newspaper and job printing press and other material of the *Weekly Star* in a neighboring town. Henry's uncle is willing to invest \$3,000 to pay for the plant, but Henry needs some \$500 more to run it during the first month or two. On June 10, 1920, Henry owns clothing, etc., valued at \$150; diamond ring \$175; horse and cart \$250; cornet \$75; skates \$10; shot-gun \$35; rifle \$20; camera \$25; war savings stamps \$85.50; on deposit in the

Central Savings Bank \$93.25; books \$22; watch \$35; fountain pen \$4; tennis racket \$8. His debts are as follows: Jones and Brown, clothing merchants, for balance on suit \$20; James Randall, blacksmith, for shoeing horse \$6, and for repairing cart \$10; subscriptions, to the Red Cross \$10, and to the Y. M. C. A. \$20.

SOLUTION: With the assistance of a friend who understands accounting, Henry prepares the following statement showing his *net worth* available for business purposes.

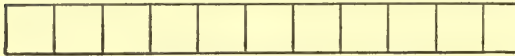
Henry Thompson
Statement of Things Owned, Things Owed, and Net Worth
June 10, 19—

<u>Things Owned:</u>	
Horse and Cart	\$ 250 -
War Savings Stamps	85.50
Central Savings Bank	93.25
Diamond Ring	<u>175 -</u>
Total	\$ 603.75
<u>Things Owed:</u>	
Jones & Brown (bal. on suit)	\$ 20 -
James Randall (shoeing horse and repairing cart)	16 -
Red Cross (subscription)	10 -
Y. M. C. A. (subscription)	<u>20 -</u>
Total	<u>66 -</u>
<u>Net Worth:</u>	
Available for business purposes	\$ <u><u>537.75</u></u>

Tabulated

Things owned.....	\$603.75
Things owed.....	\$ 66 -
Net worth.....	\$537.75

Graphic



Scale: Each $\frac{1}{4}$ inch on the bar represents \$50 in money.

COMMENTS: In the course of the preparation of the statement Henry said that he intended to sell only enough of his possessions to pay his debts and to provide about \$500 with which to operate his new business. He decides to keep for personal use all the things he owns except those listed in the statement. If the things owned which are listed in the statement should not provide sufficient money for running his new business, Henry will have to borrow money or sell some of the things owned which have not been listed.

The \$3,000 offered by Henry's uncle has not been received; therefore it has been omitted. If it had been received, it would not change Henry's net worth, because while \$3,000 would be added to *things owned*, the same amount, representing Henry's debt to his uncle, would be added to *things owed*, leaving *net worth* unchanged.

QUESTIONS

1. (a) What is meant by "business" in its broadest sense? (b) In its narrow sense?
2. Can one purchase services? Explain.
3. Classify business under four distinctive divisions.
4. Give subdivisions of each of the groups under 3.
5. (a) Distinguish between wholesale and retail business.
(b) To which group does each belong?
6. Are all retail stores small businesses? Explain.
7. What is barter? Give an example.
8. What is accounting?
9. In installing an accounting system what things must be known?
10. Does every civilized person own property? Explain.
11. (a) Name five things you own.
(b) How would you determine their money value?

12. Name some things you own that have a sentimental value.
13. Name five things you own that are necessary for your personal use.
14. How would you decide on the things that could be used for business purposes?
15. What is meant by "things owed"? Give an example.
16. What is meant by "net worth"? How is it found?
17. How would you arrange the information on a statement showing your net worth?
18. What is a graph?
19. What is a bar graph? Illustrate.
20. How may different divisions be shown on a bar that represents the whole?
21. How may the totals of things owned, things owed, and net worth be shown graphically? Illustrate.
22. Explain the solution to the Henry Thompson problem.
23. Why was the \$3,000 offered by Henry's uncle omitted from the statement?
24. What others of his assets might Henry Thompson have chosen to provide money for his business? Why?

PROBLEMS

1. (a) Prepare a statement showing your net worth available for business purposes.

(b) Illustrate the statement by a bar graph.

Arrange the statement so as to bring out most clearly the information desired.

2. Prepare such a statement, including a graph, for one or more of the following: (a) your mother, (b) father, (c) relative, (d) friend.

These statements should include only the things owned and owed that can be used for business purposes.

3. From the following information prepare a statement and a graph showing the financial condition of Charles Howard on June 30, 19—:

He owns a pony and cart valued at \$250; tennis racket \$4; boxing gloves \$10; clothes (personal) \$100; bicycle valued at \$45 on which he owes \$20; camera \$20; photographs of friends and relatives which he values at \$100, but which cannot be sold for more than 5 cents as old paper; fountain pen \$4; shot-gun \$35; books \$30. He owes for repairs to his cart \$15.

4. Mrs. Henry Hill, having recently lost her husband, desires to engage in the millinery business. She intends to sell her household goods, retaining only her personal wearing apparel and jewelry. You assist her

by making a statement including a graph as of March 25, 19—, showing her net worth based on the following data: Her husband's employers, Sinclair and Company, owe him \$50; the Home Insurance Company owes \$2,000 on her husband's life insurance policy; she has \$360 in the Union Savings Bank; she owes the doctor, James Brown, \$120; she owns a piano valued at \$450; household goods estimated to be worth \$900; clothes, jewelry, and other personal belongings which she desires to keep, worth about \$300; she owes for groceries, milk, ice, and meat, \$42; she has two \$50 Liberty bonds, worth \$50.75 each; her husband's motorcycle is estimated at \$225, on which he owes a repair bill of \$31.50.

5. After finishing high school, James Noyes wishes to go to college. He has only \$75 in money, but he also owns a bicycle worth \$50, a couple of sheep which he intends selling to his father for \$30, a colt worth \$200, some books which he can sell for \$10, and a watch worth \$10. He recently purchased a new bicycle tire from the Goodyear Rubber Company for \$3, which is included in the value of the bicycle but is not yet paid for. He also owes the Harding Company \$25 for his last suit of clothes. Prepare a statement showing his net worth as of September 1, 19—. Illustrate this with a bar graph.

6. Dick Smith decides to sell his property in Dayton, Ohio, and move to Cincinnati, Ohio. He asks you to help prepare a statement of his net worth as of June 30, 19—. You find his house and lot is worth \$10,000; household goods \$1,000; five Liberty bonds worth \$50 each; a Ford car \$300; money in First National Bank \$250. He owes for groceries \$30; for furniture, which was purchased on the instalment plan from Jacob Messenger \$150; for money borrowed from a friend, Leonard White, \$500; for dry-goods purchased from Stern and Babcock Company \$50; and he still owes to Robert Jones \$2,000 on his house and lot. Illustrate the statement with a graph.

7. William Ferris wishes to sell all his possessions and pay all his bills before joining the army. From the following information prepare a statement and a graph showing his net worth as of October 15, 19—: automobile \$700; vacant lot \$200; two shares of stock in the Napoleon Realty Company at \$100 each; personal belongings, such as a ring, watch, etc., which he also wishes to sell \$100; his brother Harry owes him on a loan \$200; he has \$250 in the Richmond Savings Bank and \$35 with him. He owes garage rent to R. H. Freeman Company for 2 months at \$5 per month; to his mother for board and room \$45; to the R. H. Freeman Company for repairs on his automobile \$20; and to R. L. Kesler for shoes \$12.

8. Your mother owns a Victrola worth \$85; Victrola records \$12; other furniture \$438; food supplies in the house \$24.50, for which she still

owes K. N. Carter, the grocer, \$8.75. She also owes \$18.25 to R. B. Newman's store for clothing, and to Bob Frey, the iceman, \$1. She has money amounting to \$37.50. What is her net worth as of August 31, 19—? Furnish statement and graph.

9. R. N. Nixon, an automobile tire repair man, wishes to sell out for a lump sum of money. In order to know what price to ask, he employs you to make up a statement of his net worth which you illustrate with a graph. You find the following on July 1, 19—: Repair outfit consisting of benches, hot plates, tools, etc., \$200; raw rubber \$30; fabric \$20; patches for inner tubes \$8; patches for outside casings \$10; air gauges \$5; hand-pumps \$20; other small accessories \$15; automobile tires on hand for sale \$225; bicycle tires for sale \$50. Bills owed to him \$175. He has \$50 in his bank. His office furniture is valued at \$50, and office supplies \$3. He owes for goods purchased \$200; for money borrowed from the Ripley County Bank \$100; for rent of building \$30; for help employed \$20; for light and heat \$5; for telephone \$3; and for express charges to Adams Express Company \$5.

10. Miss Virginia Horton, whose father recently died leaving his entire estate to her, wishes to know her net worth. She furnishes you the following information and asks you to prepare a statement showing what she owns and what she owes. Her father owned two pieces of property, one worth \$10,000 and the other worth \$15,000. His part ownership in the Blackwell Hardware Company amounted to \$5,000, in the E. H. Smith Realty Company to \$3,000. He had county road bonds worth \$2,000; five \$100 Liberty bonds worth \$102 each. His household furniture is valued at \$2,500; paintings \$500; library \$2,000. His life was insured with the Prudential Insurance Company for \$5,000, which has not yet been received. He paid \$2,000 for an automobile now worth \$1,500. He owned a diamond ring worth \$250. His bank account shows he had \$1,500 in the Second National Bank. Miss Horton herself owned before her father's death \$200 in Liberty bonds and a piano worth \$500. Before his death her father gave her a small car worth \$500 which she finds was purchased from the Ford Motor Car Company and has not yet been paid for. Her father also owed to Hudson and La Salle \$150 for a set of books; to Jacob Martin on real estate \$5,000; to Gray and Company, a clothing firm, \$125; and to J. H. Bennett, his lawyer, \$75. His unpaid doctor bill amounted to \$100, and funeral expenses were \$500. What is Miss Horton's net worth at the present time, May 15, 19—? Include a graph with your statement.

CHAPTER III

THE ACCOUNTING EQUATION

Purpose of Chapter.—

1. Meaning and use of terms “assets,” “liabilities,” and “capital.”
2. Basic accounting equation: Assets minus liabilities equals capital.

Assets.—In the practice assignment for Chapter II you prepared a list of everything you owned and learned that only those things that have a financial (money) value and that are not needed for personal use could be used for business purposes. Whatever can be used for business purposes, the accountant and the business man call assets.

Definition. An **asset** is anything having financial value that is owned by one or more persons. Examples are: a house, an automobile, a farm, a typewriter, etc. Mr. Brown has assets which he owns and Mr. Jones also owns assets. Mr. Brown can list among his assets only those things which belong to him, and Mr. Jones can list only those which he owns.

Different persons may own the same kind of assets, but they cannot each own the same asset. Mr. Brown owns \$100 in money and Mr. Jones \$50 in money. Mr. Brown includes \$100 in money among his assets, but cannot include any part of Mr. Jones' \$50. It is possible, however, for two or more persons to own parts of the same asset. Two or more men may each own part of the same building. A building and lot worth \$15,000 is owned by Jones and Brown. Jones owns a $\frac{2}{3}$ interest, or \$10,000, and Brown a $\frac{1}{3}$ interest, or \$5,000. Jones would list

among his assets \$10,000 in buildings and Brown would list \$5,000.

Liabilities.—All debts which one will have to pay in money are listed as *things owed*. To all financial obligations the term “liabilities” is given.

Definition. A **liability** is any financial debt owed by one or more persons. When a merchant buys a bill of goods for \$1,000 from Jackson and Smith and does not pay for it, he has incurred a liability which would be listed as “Unpaid Purchases Owed Jackson and Smith, \$1,000.” If he owes \$200 for rent to A. Landsdowne, it would be listed as “Unpaid Rent Owed A. Landsdowne, \$200”; and if he owes his clerk, John Abbott, \$100 for services, it would be shown as “Unpaid Salary Owed John Abbott, \$100.”

Capital.—In finding net worth the amount of things owed is deducted from things owned. The difference indicates the proprietor’s investment in the business enterprise. Another name for net worth is “capital.”

Definition. **Capital**, as used in accounting, is the owner’s investment in his business, or the excess value of assets over liabilities. If a person owns several businesses, he will have a separate capital investment in each. Carlton Adams may own a grocery store, a flourmill, and a hotel. The amount of his capital in each business is the difference between the assets and the liabilities of each enterprise. This may show that he has a capital of \$8,000 in the grocery store, \$10,000 in the flourmill, and \$12,000 in the hotel. To find the amount of capital invested by the owners in any enterprise, deduct the total liabilities from the total assets.

The Equation.—Since assets minus liabilities equals capital, an equation may express this mathematically as:

$$\text{Assets—Liabilities} = \text{Capital}$$

This may be reduced to a formula by using the initial letter of each word, thus:

$$A - L = C$$

If the assets of a business are \$800 and the liabilities \$300, the capital is \$500. Using the formula, we have:

$$A (\$800) - L (\$300) = C (\$500)$$

Instead of arranging the information in this form we may more conveniently find the capital by using the vertical form, either with or without the mathematical signs.

With Signs

A \$800
- L \$300
= C \$500

Without Signs

A \$800
L \$300
C \$500

This equation is fundamental. The whole science of accountancy is based upon it. The statement of financial condition of every business contains the three elements, assets, liabilities, and capital.

NAME OF STUDENT

Statement of Assets, Liabilities, and Capital

Date

Assets:	
Cash.....	\$500 -
Due from Smith for money lent to him.....	20 -
Etc., etc.....	<u>280 -</u>
Total.....	\$800 -
Liabilities:	
Brown and Company for unpaid instalments on	
bicycle.....	\$ 50 -
Etc., etc.....	<u>250 -</u>
Total.....	<u>300 -</u>
Capital.....	<u>\$500 -</u>

Form of the Statement.—The arithmetical form without signs is the one most frequently used when presenting the equation as of a given date. The heading of the statement frequently contains for its title line, "Statement of Assets, Liabilities, and Capital." This title is specific, and although many other titles are used it answers our purpose very well for the present.

It would appear as shown on the preceding page.

QUESTIONS

1. (a) Define "asset."
(b) Name five assets belonging to your father.
(c) Name five of your neighbor's assets.
2. Is health an asset? a pleasant disposition? a good education?
3. May an asset have more than one kind of value—personal, sentimental, business?
4. Can all of one asset be owned by two or more persons? How?
5. Define "liability." Name two liabilities of your father.
6. Is the social call you owe a friend a liability? Explain.
7. Define "capital."
8. How is the amount of the proprietor's capital in a business enterprise determined?
9. (a) What is the accounting equation?
(b) Reduce it to a formula.
10. How may the equation be used without signs? Illustrate.
11. What is the advantage of the vertical form of the equation?
12. Why is the equation, assets minus liabilities equals capital, the fundamental equation of accounting?

PROBLEMS

1. Prepare a statement showing the financial condition—assets, liabilities, and capital—of a retail grocery business in your city.

Instructions for Making the Statement

If you can make a statement for a grocery business conducted by your father, a relative, or a friend, so much the better. Otherwise visit and report on some grocery business near your school. You may be at a loss as to how to gather this information. If you are well acquainted with the

proprietor you might ask him to give you the information, but this would not develop *your* ability to gather data for a financial statement. Therefore it would be better to *estimate* the value of the visible things, imagining the other things likely to exist in such a business.

Look for two general classes of assets: (1) those bought to sell—in other words, the things in which the grocer deals; and (2) those used in carrying on the business, such as fixtures, desks, tables, cash, etc.

There are many subdivisions of group (2) and you may furnish as many of these as you wish, but only the two main groups are required. Estimate roughly the value of the assets and try to imagine the liabilities of the grocer. For example, he may owe for some of the goods in the store, for clerks' services, etc. Find the proprietor's capital and complete the statement. Do not spend more than 20 minutes in getting the necessary information from the store.

2. Write a report of not more than 150 words explaining briefly how you obtained the information for your statement.

CHAPTER IV

THE CLASSIFICATION OF ASSETS AND LIABILITIES

Purpose of Chapter.—

1. Classification and description of the assets of a trading business.
2. Classification and description of the liabilities of a trading business.

Classification.—The purpose of classification is to furnish information in a form more convenient for use. It is not sufficient for purposes of management to know that one owns a certain amount of assets and owes a certain amount of liabilities. A better view of the business is furnished by presenting a list of the different kinds of assets and liabilities, showing how much one owns or owes in each group. Compare the statement that a fleet contains 60 vessels with the statement that the fleet is composed of 10 battleships, 30 cruisers, 10 torpedo boat destroyers, and 10 torpedo boats, and note the greater amount of information contained in the latter.

In the same manner compare the two statements which follow.

It is quite evident that statement B gives more information.

A	
Assets.....	\$20,000 —
Liabilities.....	3,000 —
Capital.....	\$17,000 —

B

Assets:

Money.....	\$3,000 -	
Goods.....	8,000 -	
Debts others owe us.....	4,000 -	
Store building.....	4,000 -	
Show cases, tables, etc.....	1,000 -	
Total.....		\$20,000 -

Liabilities:

Debts owed.....	\$2,000 -	
Written promise to pay money owed.....	1,000 -	
Total.....		3,000 -

Capital:

Invested by R. F. Walker.....	\$17,000 -	

Assets.—Depending on the purpose for which the information is desired, assets may be classified in the following ways:

1. According to their physical characteristics:
 - (a) Tangible, or those easily evident to the physical senses, such as money, goods, etc.
 - (b) Intangible, or those not easily evident to the physical senses, such as patents, copyrights, trade-marks, etc.
2. According to their use for business purposes:
 - (a) Those acquired to sell, such as the goods dealt in by the merchant.
 - (b) Those acquired to be used in selling the goods dealt in, such as store building, show cases, tables, scales, etc.

For the present we shall use only the second classification.

Assets Acquired to Sell.—Assets included in 2(a) are as follows:

Merchandise. The name "Merchandise," abbreviated Mdse., is applied to that group of things acquired through purchase or manufacture by a business enterprise for the purpose of sale. Other names for this group are Stock, Merchandise Stock, Stock-in-Trade, Finished Goods, and Manufactured Goods. This group exists in every trading concern—i.e., a business where goods are bought in large quantities and sold in smaller quantities—and also in manufacturing enterprises where the article is manufactured from the raw material and then sold to other concerns. For a grocer, merchandise consists of tea, sugar, canned goods, cheese, butter, eggs, fruit, goods in cartons or boxes, candy, vegetables, etc. In fact it includes everything which he buys to sell. The main group, Merchandise, may be subdivided to any desired degree by considering one or more of the things dealt in as a distinct group. For example, a grocer might classify his merchandise into the following departments: Dairy, for all butter, eggs, and cheese; Fruit and Vegetable, for all fresh fruits and vegetables, etc.

Assets Used in Selling.—In conducting even the smallest business, several of the assets of group 2(b) are necessary. These are the tools used to enable the merchant to deal in—buy and sell—merchandise.

Cash. This title includes money and all those instruments which pass currently in business as money—in other words, anything which will be accepted by a bank as a deposit. Illustrations are gold, silver, nickel, and copper coins, United States Treasury notes, gold and silver certificates, federal reserve notes, federal reserve bank notes, national bank notes, post-office money-orders, express money-orders, bank drafts, sight or demand drafts, checks, accounts on deposit in commercial banks and trust companies, etc.

Expense Assets. This is a name given to those assets which are consumed in a short period of time, say a year or less, in conducting the business. They include wrapping paper, twine,

stationery, postage stamps, pencils, pens and ink, rent (right to use the building) paid for but not yet used, services of employees paid for but not yet received, brooms, fuel for heating purposes, etc. Other names are Service Assets, Consumable Assets, Deferred Assets, Prepaid Expenses, etc. It will of course be necessary to determine at any given time just what amount of each asset has been consumed in order to measure its present value. The part which has been consumed is no longer an asset. For example: Suppose \$600 is paid for three months' rent in advance, and that after two months have passed it is desired to know the value of the asset remaining. When the cash payment was made the \$600 cash asset was exchanged for a \$600 rent asset consisting of the right to use the building for three months. At the end of two months two-thirds, i.e., \$400, of the \$600 rent asset has been consumed, and therefore the value of the rent asset remaining is \$200.

Furniture and Fixtures. This includes all those things not consumed in, say, one year, and used along with the building in conducting the business. In this class are show cases, display racks, chairs, desks, tables, typewriters, filing cabinets, rugs, cash registers, safes, scales, etc. Other names are Store and Office Furniture and Fixtures, Store Equipment, etc.

Accounts Receivable. Under this title are amounts owed by customers or others. They are legal claims for money, owned by the proprietor, for which the customers or others have not given *written promises to pay money*. Other names are Customers, Trade Debtors, Debtors, Book Accounts Receivable, Sales Ledger Accounts, etc. Usually accounts receivable originate from the sale of merchandise to customers who do not pay for the goods at the time of the sale. This is called a sale "on account," as there is an understanding that the customer will pay for the goods later. This is brought about *orally* through spoken words, by *correspondence* through letters, orders, etc., or *implied* because the customer took the goods away with him. The merchant may keep the record (account) in any convenient

form. It may be merely a slip of paper containing the following information: date, customer's name, terms of payment, description of goods, and money value; or the record may be kept more formally in a specially ruled *book of accounts*.

Notes Receivable. This title covers all *written* promises, signed by the maker, to pay to the proprietor a certain sum of money at a definite future date. Examples are promissory notes receivable, bills of exchange, certificates of deposit, and trade acceptances receivable. The term, Bills Receivable, is also used.

Delivery Equipment. This includes all those assets having a life of a year or more, used in delivering or receiving merchandise. Examples are horses, wagons and harness, automobiles, trucks, bicycles, racks and cases, if they can be used several times, etc. Other names are Horses, Wagons and Harness, Motor Trucks, Trucking Equipment, etc.

Securities. Under this heading are listed the values of bonds or stocks owned and sometimes mortgages receivable. It is a general term and may cover Liberty bonds or other United States bonds, any industrial, mining, municipal, or public service company bonds, capital stock of any corporation, etc. Other names are Stocks, Bonds, Stocks and Bonds, Investments, or the name of the individual stock, bond, or mortgage owned.

Real Estate. This name is given to any interest in lands. In a more restricted sense it is understood to mean actual ownership of lands and buildings used in connection with a given enterprise. The term, Land and Buildings, is also often used. Two headings, one Land and the other Buildings, are preferable because they make clear the amount invested in each asset.

Other Assets. Under this title are listed all assets not classified elsewhere. Thus, where notes receivable or other investments, such as bonds, are owned, interest may have accumulated although not yet due. This is a proper asset and should not be overlooked. It may be listed with the asset, Notes Receivable, but as the amount is usually small it is best listed under Other Assets or Accruals.

Liabilities.—

Accounts Payable. This title covers items of indebtedness which the proprietor owes to others on account. They are legal claims for money owed by the proprietor, for which he has not given *written promises to pay money*. Other titles are Creditors, Trade Creditors, Book Accounts Payable, Purchase Ledger Accounts, Vouchers Payable, etc. They usually originate from the purchase of merchandise or other assets, payment not being made at the time of purchase. The legal relationship arises from the same acts as those of customers. In fact the proprietor is the customer of his creditors. Records may be kept in the same manner as for accounts receivable; or one may merely keep the invoices (bills) which he receives at the time of purchase. When payment is made the invoice should be marked "Paid" and the date of payment shown, after which it should be permanently filed. It is not advisable to destroy any business document for a number of years, as occasions may arise when it might prove useful.

Notes Payable. This heading covers all *written* promises signed by the proprietor to pay a certain sum of money at a definite future date. This may include promissory notes payable, bills of exchange, and trade acceptances payable. Another name is Bills Payable.

Mortgage Payable. This liability is one secured by a mortgage, or lien, on the real estate of the proprietor. The term, Purchase Money Mortgage, is frequently used. For example: A buys from B real estate for a price of \$20,000, agreeing to pay cash, \$8,000, at once, and the balance of \$12,000 at some future date. A takes possession of and receives title to the real estate and gives to B the \$8,000 cash, a note payable for \$12,000, and a document, called a **mortgage**, which gives B the right, if A fails to pay the note when it falls due, to take the property and have it sold, in order to collect the \$12,000 due B. After all costs of selling the property, together with the amount due B, have been deducted, the balance belongs to A. If the property sells for

less than enough to pay the costs and the amount due B, A would still owe B the difference. A, who signed the mortgage, is called the **mortgagor**, and B, in whose favor it was drawn, is called the **mortgagee**.

Other Liabilities. This includes those liabilities which have accumulated but which have not been classified. Examples are unpaid salaries, interest, advertising, wages, taxes, insurance, rent, etc. They may or may not be payable at the time the statement of assets, liabilities, and capital is prepared, but nevertheless they constitute debts owed and should be included among the liabilities. Sometimes they are listed as Accruals.

QUESTIONS

1. What is the purpose of the classification of assets and liabilities?
2. Under what six titles would you list the assets of a business if you were limited to that number in a system of classification? Give reasons for your choice.
3. What is merchandise for each of the following businesses: hardware? dry-goods? coal? meat? drug? shoe? furniture? stationery?
4. Give subdivisions of merchandise or departments for each of the types of business listed under Question 3.
5. What does a laundry deal in? taxicab stand? street railway? trucking company?
6. How can you tell whether to classify a thing as expense or furniture and fixtures?
7. Is cash money or is money cash?
8. Name three things which are classed as "securities."
9. How would you distinguish between accounts receivable and notes receivable?
10. What is an accrued asset? Name two.
11. What is an accrued liability? Name five.
12. What is the difference between accounts payable and notes payable?
13. What is real estate? What other names may be used?
14. Why is the term "Other Assets" an objectionable term to use?
15. What is a mortgage? When is it classed as an asset? as a liability?

PROBLEMS

1. Make another trip to the grocery store and this time try to recognize as many different kinds of assets and liabilities as possible, keeping in mind the classification given in this chapter. Estimate their values and prepare a statement showing assets, liabilities, and capital.

2. Henry Smith furnishes you with the information given below and requests you to prepare a statement showing his financial condition as of November 15, 19—. Merchandise \$7,460; cash \$1,640; store building and land estimated to be worth \$14,700; customers owe on account \$1,500; customers owe on written promises to pay money (notes receivable) \$2,000; auto delivery truck valued at \$800. He owes creditors on account \$1,200, and on written promises to pay money (notes payable) \$1,000; he owes clerks for salaries \$150; and taxes to the amount of \$200 are unpaid. He owns \$500 worth of Liberty bonds. Using only the amounts of total assets, total liabilities, and capital, show graphically the above information at the bottom of your statement. (See page 17 for illustration.)

3. You wish to help your father, who is a gardener, prepare a statement of his assets, liabilities, and capital as of August 1, 19—. His house and barn, worth \$5,000, are not fully paid for because Davis David has a mortgage of \$1,000 on them. The land including garden is valued at \$1,200; garden truck ready for sale \$330; accounts receivable for vegetables \$52; horse and wagon \$175. He owes on a note for horse and wagon \$75; owes you for helping in the garden \$3. Garden implements are valued at \$11.50. Your neighbor owes him \$6.50 for garden work done. Prepare graph.

4. You are employed by John Pratt, a jeweler, to prepare a statement of his assets, liabilities, and capital. After examining his books on May 1, 19—, you make up his statement from the following information: Watches of different varieties \$750; rings \$475; brooches \$50. Owes on account to E. M. Day for jewelry purchased \$350; to American Express Company for expressage on fixtures \$3; to clerks for accrued salaries \$38. He has cash in the bank and on hand \$475; stock of bracelets valued at \$75; lavalieres \$82; fancy chains \$35. His show cases and other fixtures are worth \$78; accounts receivable \$650; a desk and a typewriter \$125; stationery, postage stamps, etc., \$12. He owes on a note for the typewriter \$95; 1 month's rent unpaid \$20. There is a bill against him for electric light amounting to \$4. Prepare graph.

5. Mr. R. N. Block, dealer in women's ready-made clothing, asks you to rearrange his financial statement, grouping the assets and liabilities

according to their *use* and prepare a graph. The following is the statement as prepared by Mr. Block on March 1, 19—:

Assets:

Office furniture and fixtures	\$ 300 -	
100 suits, cost \$20 each	2,000 -	
50 fancy white waists, average cost \$5.25 each	262.50	
25 fancy colored waists, average cost \$6.00 each	150 -	
75 plain waists, average cost \$1.19 each	89.25	
Delivery car	475 -	
Office supplies	150 -	
125 pairs of shoes, average cost \$5.00 each	625 -	
U. S. bonds	550 -	
Stock of hosiery	28 -	
Goods in millinery department	325.25	
Cases, tables, etc., in store	200 -	
Other items of merchandise	415 -	
Cash	927.15	
Accounts receivable	1,280.85	
Store building and lot	3,000 -	
Total Assets		\$10,778 -

Liabilities:

La Salle and Koch, wholesale clothiers, on account	\$1,500 -	
For light, heat, and gas	15 -	
Adams Express Company for expressage	12.70	
Notes payable to James Law for merchandise	750 -	
Mortgage on store building	1,275 -	
Unpaid telephone bill	8.30	
Potter and Company, wholesale shoe house, on account	379 -	
Madison Millinery Company, on account	94 -	
Accrued salaries	126.80	
Owe Henry Jones for stationery	10.20	
Notes payable for delivery car	250 -	
Total Liabilities		4,421 -
Capital		\$ 6,357 -

6. Mrs. Amos Black is preparing to open a girls' private school. After buying what is necessary for the operation of the school, she asks you to prepare a statement and graph of assets, liabilities, and capital as of September 1, 19—. She owns furniture worth \$3,500; household fixtures other than furniture \$200; food supplies \$75; school supplies \$50; cash in Provident Savings Bank \$800; cash in the house \$50; a typewriter worth \$75; four \$50 Liberty bonds; a house and lot in a near-by town worth \$5,000. She owes on account \$50 to the Stone Book Store for school-books; \$25 to the Corner Grocery for food supplies; \$10 to Baker Piano Company for Victrola records. She owes the Knabe Piano Company \$300 unpaid instalments. She owes \$500 to her brother for money borrowed for which she gave him her note.

7. From the following information prepare a statement and graph of the financial worth of the Burroughs Adding Machine Company's Toledo, Ohio, branch as of January 1, 19—: 20 calculating machines on hand at a total cost of \$2,500; 20 ledger posting machines, 10 of which cost \$600 each and the other 10 \$800 each. Unpaid freight amounts to \$8; office furniture and fixtures \$250; a stock of 30 listing machines at \$75 each. The branch owes the Burroughs factory, on account, \$5,000; accounts payable for sundry items \$150; office stationery, price lists, etc., are valued at \$60; rent of the building paid in advance \$125; accrued salaries \$325; salesmen's expenses unpaid \$95; accounts receivable \$3,649.08; notes receivable \$1,876.92; cash \$750.

8. You are requested to assist the School Book Store in preparing a statement and graph of its assets, liabilities, and capital as of December 31, 19—. From an examination of the store you find the following: textbooks on hand \$557; books on fiction \$213; an account payable to the Leighton Book Concern \$156.18; stationery and notebooks on sale in the store valued at \$116; pencils, pens, ink, etc., for sale \$22; accounts receivable \$75.80; desks, chairs, filing cabinets, etc., \$90; a cash register recently purchased for \$75 against which is owed to the National Cash Register Company \$35 on a note; cash in the Continental Bank \$84.71; in the cash drawer at the store \$3.49. There is a stock of post-cards valued at \$12; maps \$8; pencil-sharpeners, paper weights, etc., \$18. Accrued salaries for clerk hire \$34; one month's rent of storeroom unpaid \$40; notes receivable \$47; unpaid bills for light and heat \$14.82. An old typewriter is worth \$35.

9. Dr. H. L. Nelson gives you the following information from which he wishes prepared a statement and graph of assets, liabilities, and capital as of June 30, 19—: house and lot where he lives and has his office \$5,450; a garage which he recently built at a cost of \$425. His automobile is

worth \$1,400, against which the United Motor Car Company holds two notes of \$500 each. Unpaid taxes on his property amount to \$148. He has another house valued at \$2,500 which he rents to Henry Hanson. All rent is paid up to date. The doctor holds a note for \$400 against Mrs. J. H. Kennitt. From an examination of papers in his safe-deposit box at the Milan State Bank you find he has stocks and bonds valued at \$1,975. He owes the Wilde Drug Company \$85. Accrued salary of office clerk amounts to \$15. His household goods are valued at \$1,200; office furniture and fixtures \$675; medicines on hand \$360; cash \$716.80; accounts receivable for services rendered \$609.20. He owes to the J. L. Coons Company a clothing bill of \$89.90; to the Home Grocery Company \$28.10.

10. The Studie Furniture Company employed you to prepare for them a statement and graph of their assets, liabilities, and capital as of October 31, 19—. They furnished you with the following information: Merchandise \$9,765, for which they still owe the Thompson Wholesale Furniture Company, on account, \$3,729, and on notes payable \$1,271. They have cash in the Union Trust Bank amounting to \$1,410 and in their cash drawer \$125.40. They rent their store building from Pope and Shank, to whom they have paid 2 months' rent in advance at \$150 per month. Customers owe them on account \$5,829.35 and they have notes signed by customers amounting to \$1,500. They owe clerks for salaries \$200; book-keeper \$20. Their unpaid telephone bill is \$5.25. Freight and express charges for the month of October, not yet paid, amount to \$18.75. Office supplies on hand, such as stationery, price lists, etc., are valued at \$24; office furniture and fixtures used in conducting the business \$228.25. A motor truck for delivering furniture is estimated to be worth \$1,800.

11. R. L. Glasgow, a farmer living near Napoleon, Ind., in order to open an account with a hardware company in Indianapolis, finds it necessary to submit a statement showing his assets, liabilities, and capital. He furnishes you with the following information and asks you to make a statement and graph as of October 10, 19—. His farm is worth \$6,700, against which his father holds a mortgage of \$4,000. He advises you he is in no hurry to pay the mortgage because his father is in no immediate need of the money. He has a delivery truck, fully paid for, which is worth at the present time \$550; stock of grain in his barn \$670; Liberty bonds \$1,200; hay in the barn \$35. He owes John Eckert and Son \$32.75 for a tire and \$9.25 for repairs to his truck. Accrued wages owed to farm hands \$32. Cash in bank \$487.50; wagons, buggy, harness, etc., \$335; household goods \$800; livestock, including hogs, cows, sheep, etc., \$1,060; three horses valued at \$900. The Napoleon Milling Company owes him \$95.80

for grain sold to them. He has a check for \$50.20 in the house recently received for the sale of some sheep. He owns three shares of stock in the Napoleon State Bank worth \$178 per share. He owes J. M. Martin's store \$37.25 for clothing purchased for his family. Taxes accrued but not yet due amount to \$125.

12. K. T. Baldwin, who has a small sporting goods store, furnishes you with a memorandum of the following assets and liabilities, from which you are to make up a statement and graph as of July 1, 19—, showing his capital: baseballs on hand valued at \$50; boxing gloves \$75; tennis rackets \$45; ball bats \$25; accounts payable \$318; accrued salaries \$36; shoes of various kinds \$82; caps \$24; notes payable \$75; unpaid telephone bill \$5; show cases and fixtures \$97; office desk \$18; stationery for use in the business \$11; accounts receivable \$510; bathing suits \$95; coal on hand remaining from last winter \$14; unpaid rent \$18; cash in Second National Bank \$65.

CHAPTER V

VALUATION OF ASSETS AND LIABILITIES

Purpose of Chapter.—

1. Determination of values at a given date.
2. Preparation of inventories.

Valuation.—The general purpose of valuating the assets and liabilities of a business concern is to determine the amount of capital invested. The correct value of an asset is judged (estimated or appraised) by its worth as used in carrying on the business of which it is a part. This is spoken of as “going concern” value when applied to a concern continuing in business, as distinguished from a valuation made for a concern about to go out of business and so *forced* to sell its assets for whatever a buyer will pay.

Procedure in Valuation.—Having determined, in Chapter IV, the various assets and liabilities of the ordinary trading business, such as a retail grocery, we shall now show how to arrive at the value of each of the assets and liabilities in the grocery business of Henry Martin at Kenton, Ohio. The procedure to be followed usually consists in preparing a list of the items under each classification together with such other information as may be of use. When each kind of asset or liability is studied, the student should assume that he is actually doing the work in the store. When the required work has been completed, ask your grocer or some other business man how he would have proceeded. He may point out devices which may be helpful to you.

Cash.—The value of this asset is found by preparing a list of all the things constituting cash. All the money and checks in the

safe, cash register, or cash drawer, are counted and a list is made of the number of pieces of each denomination, as follows:

Schedule No. 1

CASH

August 5, 19—

Money:

Bills

Quantity	Denomination	Amount
1	\$100	\$100 —
2	50	100 —
4	20	80 —
10	10	100 —
15	5	75 —
3	2	6 —
30	1	30 —

Total Bills..... \$491 —

Coin

Gold

4 \$5 — \$ 20 —

Silver, etc.

2	1 —	2 —
25	.50	12.50
60	.25	15 —
50	.10	5 —
50	.05	2.50
60	.01	.60

Total Coin..... 57.60

Total Money..... \$548.60

Checks:

L. C. Smith.....	\$20 —
U. R. Wade.....	7.40
Henry Rogers.....	11.50

Total checks..... 38.90

Cash in the store (money and checks)..... \$587.50

Cash in the store (money and checks).....	\$587.50
On deposit in the First National Bank.....	\$1,242.10
<i>Less</i> checks issued but not yet paid by the bank	

No.		Amount	
62	<i>O. K. 8/5/—</i>	\$ 14.70	
78	<i>B. Q. Student</i>	2.35	
95		110.45	127.50

Net amount in the bank still subject to check.....	1,114.60
Total Cash	\$1,702.10

To fix responsibility, each list should be signed or initialed by the one who prepared or verified the list. Counterfeit money or worthless checks will be omitted from the good items. It is generally sufficient to add a memorandum of the bad items, stating the maker of the check and the amount, and in the case of counterfeit money, the kind, denomination, and amount.

Notes Receivable.—The value of this asset is found in the same manner as cash. Any written *promises* to pay money, signed by others, will usually be found in the safe. It is frequently advisable to give additional information as shown by Schedule No. 2.

Schedule No. 2

NOTES RECEIVABLE

August 5, 19—

Name of Maker	Date Issued	Time	Date Due	Face	Rate of Interest	Time Elapsed	Accrued Interest
	19—		19—				
Ray Bennett.....	July 5	3 mo.	Oct. 5	\$200 —	6%	1 mo.	\$1 —
C. C. Hughes.....	Aug. 1	60 da.	Sept. 30	70 —	none	4 da.	none
H. F. White.....	June 6	90 da.	Sept. 4	150 —	6%	60 da.	1.50
Total.....				\$420 —			\$2.50*

* This item is not to be included in the total of this schedule, being shown here only as a matter of convenience in figuring the amount accrued. It appears in Schedule No. 10.

The value of the Notes Receivable may be shown in the statement of financial condition as \$420 and Accrued Interest, \$2.50, entered separately. Sometimes the two are combined as Notes Receivable and Accrued Interest, \$422.50.

Accounts Receivable.—There must be a record showing how much each customer owes. This may be in the form of slips of paper, cards, or a book account. If kept in a book, there might be a separate page for each customer. The books should be kept in the safe when not in use. The following schedule is prepared:

Schedule No. 3

ACCOUNTS RECEIVABLE

August 5, 19—

Name	When Due	Amount
J. Cohen.....	Aug. 5	\$ 15.30
A. Harris.....	" 1	19.15
Charles Howard.....	Sept. 1	8.80
Donald Kean.....	Aug. 12	21.10
Robert Kingsley.....	" 30	17.60
C. A. Mullen.....	Sept. 20	57.75
Richard Norris.....	Aug. 15	16.95
Peter Peterson.....	" 20	35.25
C. N. Smith.....	July 20	11.40
John Van Ness.....	Aug. 25	6.30
Total.....		<u>\$209.60</u>

Worthless or uncollectible accounts should be omitted because they do not represent claims having a financial value. A separate list of these should be prepared to show the loss incurred from this source during the period. Sometimes the schedule is

made in two parts, one for good accounts, the other for doubtful accounts.

Merchandise.—This asset comprises all the things in which the proprietor deals. They will be found in the storeroom and on the shelves. In the storeroom will be found full cases, boxes, barrels, and packages of goods; while on the shelves and other places of display will appear the broken lots and goods unpacked from the containers, etc., in which they were shipped. In preparing the merchandise schedule it is a good plan to use a separate list for each kind, such as (1) canned goods, (2) butter, eggs, and cheese, (3) tea and coffee, (4) spices, (5) cereals, (6) candies, (7) cookies, crackers, etc., (8) tobacco and cigars, (9) sundries (articles too small in quantity to warrant separate lists). The quantity of each article is determined and entered on the list. The various articles are then valued, i.e., priced. The multiplications and extensions are then made and the total shown. The summary of all the lists will show the value of the merchandise on hand. This work is known as “taking stock” or “inventorying,” and the list is called a “stock list” or “inventory.”

Pricing the Inventory.—The articles are listed at cost or market price, whichever is lower. When market price is higher than cost price, market price is not used because this would show in the statement of financial condition the asset, Merchandise, at a value higher than it cost, which, as the student will see later, would result in anticipating profits—the taking of profits before earning them. Furthermore, the market price is not always an indication of what the goods may be sold for, because the price may drop before the sale is made.

To illustrate this, suppose that an article costing \$5 has a market value of \$6 at inventory time. It should not be listed at \$6 because something more must be done before the extra dollar of increase can be realized. It must be sold. If \$6 is then re-

ceived for it a profit has actually been made, since the business now has \$6 cash in place of the \$5 merchandise. Profit comes only when goods are sold and not from pricing for the inventory. Accordingly merchandise should be priced at cost, or, to make sure that it is conservatively valued, at market price if that is less than cost price. Shelf-worn, damaged, or out-of-date stock, must be priced at a figure likely to be realized, considering the decrease in value of the asset that has taken place.

To illustrate the form of the inventory, we shall show only one inventory list and assume that all others have been prepared in like manner.

Schedule No. 4

List No. 1

CANNED VEGETABLES

August 5, 19—

Quantity (In dozens)	Article	Price Per dozen	Amount
36	Excelsior Corn	\$1.40	\$ 50.40
10	Golden Pumpkin	1.75	17.50
15	4x Tomatoes	1.30	19.50
8 1/2	Baby Beets	2 -	17 -
20	Early June Peas	1.50	30 -
7 (cans only)	Heinz Baked Beans	1.80	1.05
6	String Beans	1.60	9.60
3	Gilt Edge Asparagus	2.40	7.20
1 1/2	Jersey Spinach	1.90	2.85
Total			<u>\$155.10</u>

The complete inventory would be made up from the separate lists as follows:

Schedule No. 4

Summary

MERCHANDISE INVENTORY

August 5, 19—

List No.	Title	Amount
1	Canned Vegetables	\$ 155.10
2	Canned Fruit and Jellies	174.65
3	Sugar	65.45
4	Cereals, Macaroni, etc.	97.90
5	Teas and Coffees	186.70
6	Flour	76.35
7	Cookies, Crackers, etc.	34.50
8	Butter, Eggs, and Cheese	176.40
9	Spices, Baking Powder, etc.	98 —
10	And all other lists	872.20
Total		\$1,937.25

Expense Assets.—In another schedule will be placed all those things which are to be consumed in a short period of time in operating the business. Instead of determining the exact amount and value of wrapping paper, twine, paper bags, stamps, stationery, coal, insurance paid in advance, etc., which are on hand, merely a rough estimate of, say, \$150, may be shown as Schedule No. 5. To be exact, a schedule similar to the merchandise inventory would be prepared. All items must be priced at cost, because they are not to be sold but consumed, and their value therefore steadily decreases.

Furniture and Fixtures.—We list each desk, table, chair, rug, safe, typewriter, etc., used in operating the business and enter opposite each its present value to a going concern. For this pur-

pose, we may look up the bills received at the time of purchase and estimate the amount each item has decreased in value since then. If the bills cannot be found, new articles of the same kind may be priced and an estimate made of the value of the furniture and fixtures in use. Assume that these articles have been listed in Schedule No. 6 at a total of \$730.

Delivery Equipment.—This business uses a Ford delivery car two years old, estimated to be worth \$400. The grease and gasoline on hand have been included among the expense assets. Assume that Schedule No. 7 states the articles on hand at their value of \$400.

Securities.—These assets consist of stocks, bonds, and mortgages, and the proprietor would be asked to submit them to us for examination. They will usually be found in a safe-deposit box at the bank or in the safe. Since these investments are more or less permanent we shall list them at the price paid for them and add a footnote stating the market price on the date listed. The market price fluctuates and may be more or less than on the day purchased, but the amount earned each interest period—6 months in this case—will always be the same, since the interest *rate* does not change.

Schedule No. 8

SECURITIES

August 5, 19—

Quantity	Denomination	Amount	Description	Interest Rate	Interest Periods	Time Elapsed	Accrued Interest
5	\$50	\$250	U. S. Liberty Bonds	3 1/2%	June 15 & Dec. 15	51 da.	\$1.22
4	50	200	U. S. Victory Notes	4 3/4	May 20 & Nov. 20	77 da.	2 -
9		<u>\$450</u>					<u>\$3.22*</u>

* This item is not to be included in the total of this schedule, being shown here only as a matter of convenience in figuring the amount accrued. It appears in Schedule No. 10.

We find nothing but Liberty bonds and Victory notes on hand.

Real Estate.—Although this business is conducted in a building it does not necessarily follow that the proprietor of the business **owns** the building. The owner of the property is the one who holds the **title** to it, and the title is evidenced by a **deed**—a formal document transferring the title from the former to the present owner. The deed should be recorded in the official records of the county in which the property is located. The owner of the property may lease it to someone else who pays for the right to use it—rent.

Henry Martin holds the deed to the store and lot occupied by him at 236 Main St., Kenton, Ohio. By deducting from the cost of the property the decrease in value through use, it is now found to be worth \$15,000 and is so valued in Schedule No. 9. We indicate on this schedule that the building has been insured in the Mutual Fire Insurance Company for \$10,000 for a period of 3 years from August 5, 19—. Reference is also made to the fact that a mortgage of \$5,000 against the property exists, and is listed in Schedule No. 13.

Other Assets.—Other assets should be carefully estimated and listed in a separate schedule. The interest accrued on the notes receivable and the bonds found in Schedules Nos. 2 and 8 is now collected in this schedule.

Schedule No. 10

OTHER ASSETS

August 5, 19—

Interest Earned on Notes Receivable (Schedule 2)	\$2.50
Interest Earned on Bonds (Schedule 8)	3.22
Total	\$5.72

Accounts Payable.—The record showing the amount Henry Martin owes his creditors may be on slips of paper, on cards, in accounts kept in books, or in the unpaid invoices. Even when other records are kept, the invoices, since they were prepared by the creditors, are useful in verifying the correctness of the other records. Martin keeps the record of his business debts in books. To make sure that the accounts are correct we compare them with the unpaid invoices, and then prepare a list of his trade creditors as follows:

Schedule No. 11

ACCOUNTS PAYABLE

August 5, 19—

Name	When Due	Amount
H. F. Sends	Aug. 10	\$ 240 -
King and Cohen	" 20	430 -
American Grocery Company	" 30	182 -
Meyers and Company	Sept. 7	167 -
Total		<u>\$1,019 -</u>

Notes Payable.—Every prudent man keeps a record of each written promise to pay money which he has issued, showing the date, to whom issued, amount, rate of interest, time or when due, and for what given. The simplest record is kept in a book of blank forms of notes, perforated at the left end, the stub—i.e., the part remaining in the book—containing lines for the information noted above. After a note has been paid it may be marked "Paid" and attached to its stub, or the stub marked "Paid" and the canceled note placed in the safe. Under another plan all notes issued are recorded in a book with columns for the desired information.

Mr. Martin has recorded his notes payable in a book of blank forms with stubs. We compare the stubs marked "Paid" with the canceled notes and accept the other stubs as representing the notes unpaid. Martin might have issued some notes and forgotten to make a record on the stubs, but this is not likely if all notes are issued from one source, because the unfilled stubs would call attention to the matter. From the stubs we prepare a list of notes outstanding.

Schedule No. 12

NOTES PAYABLE

August 5, 19—

To Whom Given	Date Issued	Time	Date Due	Face	Rate of Interest	Time Elapsed	Accrued Interest
	19—		19—				
American Grocery Co..	June 5	6 mo.	Dec. 5	\$300 -	6%	2 mo.	\$3 -
H. Hudson.....	July 26	30 da.	Aug. 25	420 -	6%	10 da.	.70
R. Brewster.....	Aug. 2	90 da.	Nov. 30	75 -	none	3 da.	none
Total.....				\$795 -			\$3.70*

The amount of Notes Payable may be stated as \$795 in the statement of assets, liabilities, and capital and another item, Accrued Interest \$3.70, entered separately, or the two totals may be combined as Notes Payable and Accrued Interest, \$798.70.

Mortgage Payable.—A record of a mortgage on the property may or may not be kept. Usually only one mortgage is given in a small business and the proprietor has little difficulty in remembering the item. To determine whether or not a mortgage against the property exists, one would ask the proprietor, or, better still, have a search made of the official records of the county

* This item is not to be included in the total of this schedule, being shown here only as a matter of convenience in figuring the amount accrued. It appears in Schedule No. 14.

in which the property is located. Martin informs us that he owes B. L. Young \$5,000 on the purchase of the building and lot and has given Young as security a 5-year mortgage for \$5,000 at 6%, dated April 5, 1920. We list this under Schedule No. 13 and add a memorandum, stating that 4 months' interest at 6%, \$100, has accrued on the mortgage.

Other Liabilities.—With Mr. Martin's assistance we discover additional liabilities shown below. Items owed but not yet due are called "accrued liabilities" or "accruals." We list here also the interest accrued on the notes payable and on the mortgage.

Schedule No. 14

OTHER LIABILITIES

August 5, 19—

Interest accrued on notes payable (Schedule 12)	\$	3.70
Interest accrued on mortgage payable (Schedule 13)		100 —
Clerks' salaries owed but not due:		
G. D. Jones	\$20	
B. L. White	15	35 —
Taxes on land and building estimated to date		90 —
Repairs on delivery car owed to R. B. Black		18 —
Total	\$	246.70

Summary of Schedules.—It is not necessary to prepare schedules in the exact sequence followed above. Another order would do equally well. For example, the schedule of accounts payable might have been prepared before that of expense assets. We now prepare a statement of assets, liabilities, and capital, which is merely a summary of the various schedules.

When making a statement of assets, liabilities, and capital, it is customary to arrange the items in a definite order. In a trading business the assets which are used in trading usually

appear first. Thus, Cash, Notes Receivable, Accounts Receivable, and Merchandise should be shown in that order. Following these should appear the Expense assets and the Furniture and Fixtures, Buildings, Land, etc. This arrangement of the assets is in accordance with the relative degree of liquidity of the various items.

HENRY MARTIN

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

AUGUST 5, 19—

Assets:		
Cash.....	(Schedule 1)....	\$1,702.10
Notes Receivable.....	(Schedule 2)....	420 -
Accounts Receivable....	(Schedule 3)....	209.60
Merchandise.....	(Schedule 4)....	1,937.25
Other Assets.....	(Schedule 10)...	5.72
Securities.....	(Schedule 8)....	450 -
Expense Unconsumed...	(Schedule 5)....	150 -
Furniture and Fixtures..	(Schedule 6)....	730 -
Delivery Equipment....	(Schedule 7)....	400 -
Real Estate.....	(Schedule 9)....	15,000 -
Total Assets.....		<u>\$21,004.67</u>
Liabilities:		
Accounts Payable.....	(Schedule 11)...	\$1,019 -
Notes Payable.....	(Schedule 12)...	795 -
Other Liabilities.....	(Schedule 14)...	246.70
Mortgage Payable.....	(Schedule 13)...	5,000 -
Total Liabilities.....		<u>7,060.70</u>
Capital:		
Invested by Henry Martin.....		<u>\$13,943.97</u>

By liquidity is meant the readiness or ease with which the various assets are converted into cash in the regular course of business. Cash is the most liquid; it is ready without change for

any use. Notes and accounts receivable must be collected before they can ordinarily be used, and merchandise must be sold and the money arising out of its sale must be collected. Certain assets, such as buildings, land, furniture and fixtures, are not usually sold in the regular course of trading and are therefore not liquid. They are called "fixed."

Since cash—and sometimes other liquid assets—is used to pay debts, it is customary to arrange the liability items in the order of their currency. By this is meant that those liabilities which will ordinarily have to be paid off by using the cash and other liquid assets should be shown first. Thus, Notes Payable and Accounts Payable will appear first in the liability section of the balance sheet and will be followed by Mortgage Payable and other items which will not have to be paid off within so short a period of time.

Hereafter, in all statements of assets, liabilities, and capital, the asset and liability items should be arranged as explained above.

QUESTIONS

1. What is the main purpose of valuation in a going business?
2. In finding the amount of cash in bank subject to check, why are the checks outstanding deducted from the amount on deposit in the bank?
3. How may the value of an interest-bearing note receivable be stated in the schedule?
4. In what different ways can accounts receivable be kept?
5. How would you find the inventory of merchandise in a shoe store? dry-goods store? lumber yard?
6. At what price is the inventory of merchandise valued? Why?
7. How are expense assets valued? Why?
8. At what price should damaged merchandise be inventoried? Why?
9. How would you arrive at the value of furniture and fixtures and delivery equipment?
10. Does every business man own his place of business? Why?
11. (a) What do you understand by securities? (b) How would you value them?
12. Does fire insurance make a building worth more? Why?

13. How can one prove that he is the owner of a piece of real estate?
14. In what different ways can accounts payable be kept?
15. Why should a record be kept of notes payable?
16. What may a schedule of other liabilities contain?
17. In what order should assets and liabilities be arranged in a statement of assets, liabilities, and capital? Why?

PROBLEMS

Visit your grocery store again and observe the business for the purpose of valuing its assets and liabilities as a going concern. Ask the proprietor and other people any questions that you think will aid you.

1. Write a brief report, not more than 2 pages, explaining your purpose in reporting on the store and what you did on this visit. This is not intended to be a report on the work to be done in preparing the various schedules, but more to get your ideas as to why we want this information and what questions you asked others.

2. Explain in detail (orally) the procedure to be followed in determining the value of the various groups of assets and liabilities in the statement of Henry Martin.

3. If possible obtain one or more sheets of an actual inventory, or if that cannot be done try to secure one or more of the sheets used to record articles inventoried—blank inventory sheets.

CHAPTER VI

CAUSES OF CHANGES IN CAPITAL

Purpose of Chapter.—

1. Comparison of assets and liabilities at beginning and end of a period, and effect on capital.
2. Profits, operating and anticipated.
3. Expenses, operating, non-operating, and anticipated.
4. Contributions and withdrawals of assets.

Comparison.—Comparison is used to determine change in financial condition. We have learned how to determine the assets, liabilities, and capital of a concern on a given date. We learned further that the information so obtained is useful in managing a business enterprise. More information, however, can be obtained by comparing the statements of assets, liabilities, and capital of the same business for two dates, such as December 31, 1919, and December 31, 1920. The most direct method of determining change in financial condition is to find the increase or decrease of capital at the last date over the capital at the first date. Thus A's capital at the first date may be \$1,000 and at the last date \$1,500, or an increase of \$500.

Changes in Financial Condition.—The cause of the change in capital is found in the changes in assets and liabilities. The following examples will illustrate the manner in which increases and decreases in capital are brought about. In each example the financial condition of the business at the first date is shown, immediately followed by its condition on the second date. After this is given the result of comparison of the two statements. A graphic illustration of each is also presented.

The following changes in financial condition are discussed:

1. Increase in capital
2. Decrease in capital
3. No change in capital

1. Increase in Capital.—

Case 1. Assets increase and liabilities remain the same.

First Date		Second Date		Result	
A	\$500	A	\$600	Increase	\$100
L	<u>200</u>	L	<u>200</u>	No change	
C	<u>\$300</u>	C	<u>\$400</u>	Increase	<u>\$100</u>
A		A		A Inc.	
L		L		L	
C		C		C Inc.	

Comparing assets under Second Date with assets under First Date we find an increase of \$100, which is stated under Result. Comparing liabilities we find no change, and comparing capital we find an increase of \$100. The source of the increase in capital is indicated under Result: An increase in assets of \$100 with liabilities remaining unchanged results in an increase in capital of \$100.

Scale: In each of the graphs every three-sixteenth inch ($3/16$ inch) represents a money value of \$100.

Case 2. Assets remain the same and liabilities decrease.

First Date		Second Date		Result	
A	\$500	A	\$500	No change	
L	<u>200</u>	L	<u>100</u>	Decrease	<u>\$100</u>
C	<u>\$300</u>	C	<u>\$400</u>	Increase	<u>\$100</u>
A		A		A	
L		L		L Dec.	
C		C		C Inc.	

Case 3. Assets increase and liabilities increase less.

First Date		Second Date		Result	
A	\$500	A	\$700	Increase	\$200
L	<u>200</u>	L	<u>300</u>	Increase	<u>100</u>
C	<u>\$300</u>	C	<u>\$400</u>	Increase	<u>\$100</u>
A		A		A Inc.	
L		L		L Inc.	
C		C		C Inc.	

Case 4. Assets decrease and liabilities decrease more.

First Date		Second Date		Result	
A	\$500	A	\$400	Decrease	\$100
L	<u>200</u>	L	<u>0</u>	Decrease	<u>200</u>
C	<u>\$300</u>	C	<u>\$400</u>	Increase	<u>\$100</u>
A		A		A Dec.	
L		L		L Dec.	
C		C		C Inc.	

Case 5. Assets increase and liabilities decrease.

First Date		Second Date		Result	
A	\$500	A	\$550	Increase	\$50
L	<u>200</u>	L	<u>150</u>	Decrease	<u>50</u>
C	<u>\$300</u>	C	<u>\$400</u>	Increase	<u>\$100</u>
A		A		A Inc.	
L		L		L Dec.	
C		C		C Inc.	

2. Decrease in Capital.—

Case 1. Assets decrease and liabilities remain the same.

First Date		Second Date		Result	
A	\$500	A	\$400	Decrease	\$100
L	<u>200</u>	L	<u>200</u>	No change	
C	<u>\$300</u>	C	<u>\$200</u>	Decrease	<u>\$100</u>
A		A		A Dec.	
L		L		L	
C		C		C Dec.	

Case 2. Assets remain the same and liabilities increase.

First Date		Second Date		Result	
A	\$500	A	\$500	No change	
L	<u>200</u>	L	<u>300</u>	Increase	\$100
C	<u>\$300</u>	C	<u>\$200</u>	Decrease	<u>\$100</u>
A		A		A	
L		L		L Inc.	
C		C		C Dec.	

Case 3. Assets decrease and liabilities decrease less.

First Date		Second Date		Result	
A	\$500	A	\$300	Decrease	\$200
L	<u>200</u>	L	<u>100</u>	Decrease	<u>100</u>
C	<u>\$300</u>	C	<u>\$200</u>	Decrease	<u>\$100</u>
A		A		A Dec.	
L		L		L Dec.	
C		C		C Dec.	

Case 4. Assets increase and liabilities increase more.

First Date		Second Date		Result	
A	\$500	A	\$600	Increase	\$100
L	<u>200</u>	L	<u>400</u>	Increase	<u>200</u>
C	<u>\$300</u>	C	<u>\$200</u>	Decrease	<u>\$100</u>
A		A		A Inc.	
L		L		L Inc.	
C		C		C Dec.	

Case 5. Assets decrease and liabilities increase.

First Date		Second Date		Result	
A	\$500	A	\$450	Decrease	\$50
L	<u>200</u>	L	<u>250</u>	Increase	<u>50</u>
C	<u>\$300</u>	C	<u>\$200</u>	Decrease	<u>\$100</u>
A		A		A Dec.	
L		L		L Inc.	
C		C		C Dec.	

3. No Change in Capital.—

Case i. Assets and liabilities increase equally.

First Date		Second Date		Result	
A	\$500	A	\$600	Increase	\$100
L	<u>200</u>	L	<u>300</u>	Increase	<u>100</u>
C	<u>\$300</u>	C	<u>\$300</u>	No change	<u>—</u>
A		A		A Inc.	
L		L		L Inc.	
C		C		C	

Case 2. Assets and liabilities decrease equally.

First Date		Second Date		Result	
A	\$500	A	\$300	Decrease	\$200
L	<u>200</u>	L	<u>0</u>	Decrease	<u>200</u>
C	<u>\$300</u>	C	<u>\$300</u>	No change	
A		A		A Dec.	
L		L		L Dec.	
C		C		C	

Sources of Increases in Capital.—Increase in capital does not necessarily indicate profit. It merely shows that a change has occurred; not *how* it occurred. To show *how* changes in assets will cause changes in capital let us consider in detail the case where assets increase and liabilities remain the same.

An increase in capital brought about by an increase in assets may be caused by: (1) operation of the business, or (2) an additional investment by the proprietor.

1. Operating Profits.—An increase in capital may result from the sale of an asset for more than its cost. Suppose that merchandise costing \$100 has been sold for \$125 in cash. The asset, merchandise, has decreased \$100 and the asset, cash, has increased \$125, with a resulting increase of \$25 in total assets. Since the liabilities remain unchanged, capital has increased \$25. This increase is an **operating profit** because it is the result of using the assets to produce other assets of greater value than originally existed. It is also called a **realized profit** because nothing more need be done to secure the \$25 increase.

Capital sometimes appears to increase when the market value of an asset increases. For example, we may own a piece of land that cost \$5,000. If the market value increases to \$7,000, there may appear to be a \$2,000 increase in capital. This, how-

ever, is not yet a fully earned profit. The land must be sold before the profit can be realized. An increase in capital brought about merely by an increase in value of an asset is called an **anticipated profit**. Since it is unrealized profit, it is best not to count it, and to continue to value the asset at its original cost.

2. Additional Investment by the Proprietor.—The proprietor may contribute additional cash or other assets, increasing the assets while the liabilities remain the same, thus bringing about an increase of capital. Such an increase in capital is not considered profit because the increase is not the result of operating the business, that is, using the assets to produce more value than originally existed. To illustrate, suppose that before any operations occur the proprietor makes an additional investment of \$200 in cash. The following statement will show the effect on capital.

Before		After		Result	
A	\$500	A	\$700	Increase	\$200
L	200	L	200	No change	
C	<u>\$300</u>	C	<u>\$500</u>	Increase	<u>\$200</u>

It is readily seen that the present capital of \$500 is composed of two parts, one consisting of the original investment of \$300, and the other the \$200 additional investment. Since there has been no increase in capital from operations there can be no profit.

Sources of Decreases in Capital.—Capital decrease does not necessarily mean a loss of assets in the sense that the word is used when we speak of the loss of \$5 in money, or the loss of an uninsured building. On pages 57 and 58, under the heading, "Decrease in Capital," it has been shown that either a decrease of assets or an increase of liabilities will cause a decrease of capital. Since, however, a capital decrease due solely to an increase of liabilities is not often met with, in the present discussion only

decrease in capital caused by a decrease of assets will be considered. This usually results from: (1) a consumption of assets in operating the business, or (2) a withdrawal of assets by the proprietor.

1. Consumption of Assets in Operation.—In every going concern expense assets, such as rent, insurance, clerks' services, postage stamps, wrapping paper, fuel, stationery, etc., are consumed. The right to use a room or building for carrying on the business for a period—month or year—is given in exchange for the asset, cash. Day by day this right decreases, thus decreasing the expense asset, rent (the right to use the building), and decreasing capital in much the same manner as when the asset, paper, is used to wrap an article sold to a customer.

Expense assets consumed in the effort to increase total assets are known as **operating expenses**. Among the operating expenses of some firms will be found thousands of dollars' worth of advertising consumed in an effort to increase their capital by making large sales at a profit. These profits must exceed all operating expenses, else a loss results, because the new assets acquired are less than the expense assets consumed and the cost of the merchandise assets sold.

(a) Operating Expenses.—Since the chief function of a trading business is the buying and selling of merchandise, the operating expenses of such a business are chiefly those concerned with: (1) acquiring merchandise, and (2) disposing of it. The usual point of separation between these two groups of expenses is at the place where the goods are ready to be sold to the customer. All assets used in the purchase of merchandise comprise the cost of the merchandise. Thus if the price of the merchandise bought is \$100 and \$10 is paid for freight and \$2 for cartage, the cost of the merchandise is not \$100, but \$112. The \$12 comprises the cost of acquiring the merchandise and is included as a part of the cost of the merchandise. All expense assets consumed in disposing

of merchandise are called **outgoing expenses**. Outgoing expenses begin therefore when the effort to sell begins; in other words, outgoing expenses begin after incoming expenses have ceased.

Outgoing expenses are not treated as a part of the cost of merchandise, but are deducted from the difference between the sales price and the total cost price of the merchandise when sold. This difference between sales and cost price of merchandise sold is called **gross profit**. If the merchandise in the above example is sold for \$150 cash and the expense assets consumed in making the sale and operating the business amount to \$15 for salesmen's salaries, rent, light, heat, paper, advertising, insurance, etc., the net result of the transaction would be indicated in this manner:

Increase in asset, cash.....	\$150
Less: Decrease in asset, merchandise.....	112
Equals gross increase in assets subject to reduction.....	\$ 38
Less: Expense assets consumed.....	15
Equals net increase in assets.....	<u>\$ 23</u>

This net increase in assets of \$23 must bring about a like increase in capital.

The net result would be the same if the outgoing expenses of \$15 had been added to the \$112 of merchandise cost and this amount, \$127, subtracted from the sales price of \$150, leaving a remainder of \$23. If it were possible in actual business to determine as each sale is made just exactly what proportion of the outgoing expenses—salesman's salary, rent, advertising, etc.—is applicable to that sale, the net result could be determined by adding these expenses to the cost of the merchandise sold. But where sales are being made constantly, it is impossible to apportion the outgoing expenses to each sale. Accordingly, it is the practice to add all incoming expenses wherever possible to the cost of merchandise, but to subtract outgoing expenses from the gross profit.

In a small business it is not always easy to separate all incoming and outgoing expenses. Thus a clerk may spend part of his

time in connection with buying goods and part in disposing of them. Where separation of the time is difficult, the entire expense is usually listed with the outgoing expenses. Incoming expenses are incurred whenever goods are bought; the merchant cannot escape them. If he buys merchandise, he must pay all costs to get it into his possession. Over outgoing expenses, however, he has a closer control. If he does not desire to spend money (cash) for advertising he does not have to. If salesmen's salaries are costing too much he may dismiss some of his salesmen. If rent is too high he may move to less expensive quarters. About all of these things he must exercise his judgment. If these operating expenses result in profits in excess of what he could make without incurring them, good business judgment dictates that he should not attempt to cut down his expenses. Outgoing expenses must always be measured against the gross increase in capital which they produce.

If merchandise has been damaged in handling, gone out of style, become shelf-worn, or if prices have decreased, it may be necessary to sell the merchandise below cost. This will result in a decrease in capital. Thus, if goods costing \$50 are sold for \$40 in cash, the asset, merchandise, has been decreased \$50 and the asset, cash, has been increased \$40. As a result there is \$10 less in total assets, and since liabilities have not changed, there is also a net decrease in capital of \$10. This may be considered as a bonus to induce the customer to take the goods. Hence it is an operating expense.

Sometimes a merchant offers old stock at less than cost to dispose of it quickly and make room for new stock. Again it is often advisable to sell goods at a little under cost at once rather than chance a further decline in market value and a greater loss at a future date. All such sales are a matter of business policy and therefore these losses are operating expenses.

(b) Non-Operating Losses.—When a concern loses cash or other assets through burglary, theft, or accident, it is considered

a non-operating loss or expense. The loss of a sum of money on the street, the partial or complete destruction of an uninsured building, the loss of merchandise or cash through theft or burglary, are examples. As these do not occur under normal conditions they are not operating expenses. They nevertheless reduce assets, and since liabilities are not affected, there is a reduction in capital. As they are unexpected losses, they ought not to be included with the regular and usual expenses incidental to the normal operations of the business. They do not in any sense bring in new customers or increase the sales to old customers.

(c) **Anticipated Losses.**—Just as a profit may be anticipated (see page 60) so may a loss be anticipated. The market value of an asset may decrease. This loss has not been the result of operating the business, but has been due to changes in the market. Except in the case of merchandise, changes in the market should not be allowed to make any change in the valuation of an asset. The furniture and fixtures, the delivery equipment, etc., of a going business are not for sale; the business needs them for operating. If they decrease in market value, it makes little or no difference to the owner because he does not expect to sell them; he will continue to use them. Hence he will not sustain a loss arising from a change in the market.

Because the loss is not sustained, the asset will continue to be valued at its original cost less the value of the portion used up or worn out in operating the business.

Since merchandise, however, is acquired only for resale, it is valued at market when market price is lower than cost price. While this actually anticipates the loss—i.e., considers it as having happened before the sale was made and the loss actually sustained—it is justified on the ground of conservative business practice which recognizes all losses likely to occur and makes provision for them. It is not considered good practice, however, to anticipate profits on unsold merchandise when the market price is higher than the cost price. A business man always

prefers to be on the safe side and not to count his profits until his goods are sold, but to make adequate provision for all losses which he may have to face in the future.

2. Assets Withdrawn by the Proprietor.—Withdrawal of cash or other assets by the proprietor for his personal use results in a decrease in capital. This is in no sense a loss, because it consists merely in the transfer of assets belonging to the proprietor. Let the proprietor's business condition be as represented by the first example below. He withdraws \$100 in cash. This will decrease the assets from \$500 to \$400 without changing the liabilities. His capital must therefore be \$100 less than it was. The change in capital is fully explained by the decrease in assets from \$500 to \$400 due to the proprietor's withdrawal. This decrease in capital has not resulted from conducting the business, hence no loss has occurred, i.e., the proprietor, personally, still has the same total amount in assets, but not so much of them is invested in this particular business.

Before		After		Result	
A	\$500	A	\$400	Decrease	\$100
L	200	L	200	No change	
C	<u>\$300</u>	C	<u>\$200</u>	Decrease	<u>\$100</u>

QUESTIONS

1. What is the purpose of comparing statements of assets, liabilities, and capital?
2. What is the most direct method of determining a change in the financial condition of an enterprise?
3. What causes the change in capital?
4. Illustrate and explain five changes in assets and liabilities that will result in an increase in capital.
5. Illustrate and explain five changes in assets and liabilities that will result in a decrease in capital.
6. Illustrate and explain two changes in assets and liabilities that will result in no change in capital.

7. Name the two usual sources of increase in capital caused by increase of assets.
8. Does an increase in capital always indicate a profit? Explain.
9. What is meant by "profits from operation"?
10. What is meant by "anticipating profits"? Illustrate.
11. Prove that an additional investment by the proprietor is not profit.
12. Name the two usual sources of decrease in capital caused by decrease of assets.
13. Why are freight and other incoming expenses added to the cost of merchandise bought?
14. What is meant by "operating expenses"? Are they losses? Explain.
15. Name the two main groups of operating expenses.
16. At what point do outgoing expenses begin? Illustrate.
17. What do you understand by gross profit? Illustrate.
18. Why should outgoing expenses be deducted from gross profit rather than be added to the cost of merchandise?
19. Are incoming and outgoing expenses always separated? Explain.
20. Explain the effect on capital of the sale of merchandise at less than cost.
21. What is a "non-operating loss"? Give four examples.
22. What is an "anticipated loss or expense"? Illustrate.
23. Why is unsold merchandise valued at market price when market price is less than cost?
24. Why is unsold merchandise valued at cost price when market price is higher than cost?
25. Show why a decrease in capital caused by the withdrawal of assets by the proprietor for his personal use is not a loss.

PROBLEMS

Note: In solving Problems 1 to 14 inclusive, arrange your solutions according to the forms shown on pages 55 to 59. Do not forget to make a graphic solution just beneath the numerical solution.

1. On December 31, 1919, John Davis had assets of \$1,000; liabilities of \$200; capital \$800. During the following year his assets increased \$200; liabilities remained the same. What was his capital on December 31, 1920?
2. On December 31, 1919, James Harrigan had assets of \$1,200; liabilities of \$500; capital \$700. During the year 1920 his liabilities decreased \$100; his assets remained the same. What was his capital December 31, 1920?

3. On June 30, 1919, Harry Fish had assets of \$600; liabilities of \$100; capital \$500. On June 30, 1920, his assets were \$650; liabilities \$125. What was his capital?

4. On June 30, 1920, Marie Terrott had assets of \$700; liabilities of \$300; capital \$400. During the following year her assets decreased \$25; liabilities decreased \$50. What was her capital June 30, 1921?

5. On March 1, 1919, William Horn had assets of \$800; liabilities of \$350; capital \$450. On March 1, 1920, his assets amounted to \$850, liabilities \$325. What change was made in his capital?

6. On July 1, 1921, Emma Clark had cash of \$100 and owed to her mother \$25. On August 1 she had cash of only \$95, and still owed her mother \$25. What was the difference in her capital?

7. You prepared a statement for George Cass showing his assets to be \$500; liabilities \$100; capital \$400. The next day he advised you he owed \$25 more than was included in his statement. What was his correct capital?

8. On October 31, Frank Simons had assets of \$600; liabilities of \$200; capital \$400. On December 31 of the same year his assets amounted to \$500; liabilities of \$175. What was the decrease in his capital?

9. During a certain year, J. L. Julian's assets increased from \$1,000 to \$1,050, while his liabilities increased from \$500 to \$600. What difference was made in his capital?

10. During the year of 1920 Ed. Friend's assets decreased \$50, and his liabilities increased \$200. At the end of the year he had assets of \$750 and liabilities of \$500. What was his capital at the beginning of the year?

11. On December 31, 1920, you prepared a statement for James Day showing his assets to be \$600 and liabilities \$100. At the end of the following year you found that his assets had increased \$100 and his liabilities had also increased \$100. What was his capital at the end of the year?

12. On May 1, Mary Haskins had assets of \$90; liabilities of \$30; capital \$60. On June 1 of the same year she found that her assets had decreased \$10 and that she had liabilities of only \$20. What was her capital on June 1?

13. Dallas Lawrence had, on February 1, 1921, assets amounting to \$600; liabilities of \$200; capital \$400. During the month he lost on the street \$5 and had another \$5 stolen from him. At the end of the month he still had liabilities of \$200. What was his capital?

14. Jack Breeze had assets on August 1, of \$200 and he had no liabilities. During the month his mother gave him \$20 for a birthday present. He had a watch repaired by James Horn for which he was charged \$5. On September 1, he had not yet paid Mr. Horn, but he had no other

liabilities or assets except as mentioned above. What was his capital on September 1?

15. A proprietor sold merchandise for \$2,000 that cost him \$1,500. What kind of profit is the \$500 increase in assets?

16. A proprietor sold merchandise for \$750 that cost him \$500. What does the \$250 increase in assets represent?

17. A proprietor made an additional investment of \$1,000. Does it represent a profit to the business? How does it affect the capital?

18. A building worth \$10,000 at the beginning of the year is valued at \$11,000 at the end of the year. What would you call the difference of \$1,000?

19. A piece of land that cost \$8,000 was at the end of 5 years valued at \$10,000. Did the owner realize a profit? At what figure should he list the land among his assets?

20. What kind of assets are such items as rent, insurance, postage, and clerks' services?

21. A merchant bought merchandise for \$200 and paid freight on it of \$4. What assets did he receive? He sold the merchandise for \$250. What was his profit?

22. A merchant bought merchandise for \$500. He paid \$10 freight on it and his salesman's salary and expenses while selling it was \$25. The merchandise was sold for \$700. What was the gross increase in assets? The net increase? What was the net effect on his capital?

23. Explain the nature of the following items: freight on incoming merchandise; rent of building; freight on merchandise sold; advertising; charges for hauling incoming merchandise from freight office to storeroom.

24. A merchant sold merchandise for \$200 that cost \$250.

(a) Did this transaction result in an increase or decrease in capital?

(b) How would you proceed to prove this?

25. A proprietor who had \$12,000 invested in business withdrew \$2,000. Does the \$2,000 represent an expense? What effect does the withdrawal have upon the capital? Why?

26. A proprietor lost \$500 through burglary. What kind of loss does it represent?

27. A stock of merchandise cost \$2,000. Before it was sold the market price was \$1,800. What kind of loss does the \$200 represent? At what figure should the merchandise be listed among the assets? Why?

28. Furniture and fixtures were purchased for \$1,200. At the end of the year they are worth only \$1,000. What does the difference represent? What is the difference between this decrease and the decrease in Problem 27?

CHAPTER VII

COMPARATIVE STATEMENTS OF FINANCIAL CONDITION

Purpose of Chapter.—

1. Purpose of comparative financial statements.
2. Changes in individual assets and liabilities.
3. Result, not cause, of changes shown.

Form of the Comparative Statement.—The following statement shows the financial condition of Henry Brown as of December 31, 1919, and December 31, 1920, in comparative form:

HENRY BROWN

COMPARATIVE STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL December 31, 1919, and December 31, 1920

	Dec. 31, 1920	Dec. 31, 1919	Increase	Decrease	
Assets:					
Cash.....	\$ 700 -	\$ 1,500 -		\$800 -	
Accounts Receivable..	6,000 -	4,000 -	\$2,000 -		
Notes Receivable.....	2,500 -	2,000 -	500 -		
Merchandise.....	10,000 -	8,000 -	2,000 -		
Expense Assets.....	200 -	300 -		100 -	
Furniture & Fixtures..	1,200 -	1,000 -	200 -		
Real Estate.....	12,000 -	10,000 -	2,000 -		
Total.....	\$32,600 -	\$26,800 -	\$6,700 -	\$900 -	Net Inc. \$5,800 -
Liabilities:					
Accounts Payable....	\$ 4,000 -	\$ 5,000 -		\$1,000 -	
Notes Payable.....	2,000 -	1,000 -	\$1,000 -		
Mortgage Payable....	2,000 -	5,000 -		3,000 -	
Total.....	\$ 8,000 -	\$11,000 -	\$1,000 -	\$4,000 -	Net Dec. 3,000 -
Capital:	\$24,600 -	\$15,800 -	Net increase in capital		\$8,800 -

Summary of Increases and Decreases

Asset increases.....	\$6,700 -	
Asset decreases.....	900 -	
Net increase in assets.....		\$5,800 -
Liability decreases.....	\$4,000 -	
Liability increases.....	1,000 -	
Net decrease in liabilities.....		3,000 -
Increase in capital.....		\$8,800 -

Instead of using two columns for changes in assets and liabilities, one column may be used by heading it "Increase and Decrease" and writing increases in black and decreases in red. The column may also be headed

Increase +
Decrease -

requiring only one color, each amount being preceded or followed by the sign + or - to indicate increase or decrease. The total and net increases should be stated no matter which form is used.

Comparing Totals.—The increase in capital of \$8,800 occurred through increase in assets of \$5,800, and decrease in liabilities of \$3,000. In Chapter VI, page 56, under the heading "Increase in Capital" it is shown that the effects on capital of a decrease in liabilities and of an increase in assets are the same. Therefore, the \$3,000 decrease in liabilities must be added to the \$5,800 increase in assets to show the change in capital. If assets and liabilities have been valued properly and if the proprietor has neither made additional investments nor withdrawn capital, the increase of \$8,800 in capital represents net profit.

The changes in assets, liabilities, and capital may be stated as follows:

Increase in assets.....	\$ 6,700 -	
Plus decrease in liabilities.....	4,000 -	
Has the effect of increasing capital.....		\$10,700 -
Decrease in assets.....	\$ 900 -	
Plus increase in liabilities.....	1,000 -	
Has the effect of decreasing capital.....		1,900 -
Difference shows net increase in capital.....	\$ 8,800 -	

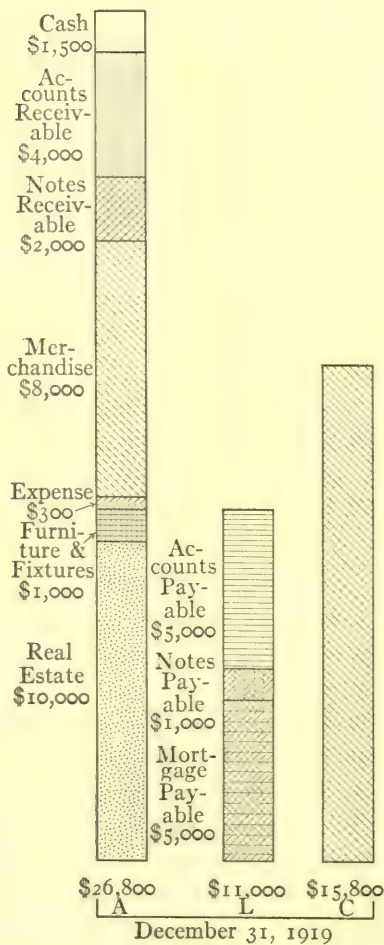
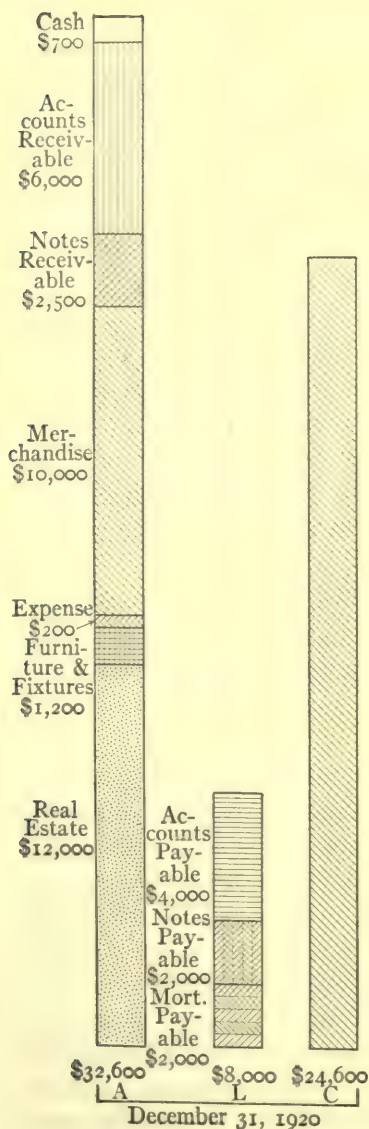
The comparative statement gives no information as to proprietor's investments and withdrawals. Therefore we cannot tell if the increase in capital of \$8,800 has been earned from operations or not. If Brown has contributed assets during the year, the amount so contributed must be deducted from the \$8,800, and if he has withdrawn assets, the amount so withdrawn must be added to the \$8,800 to determine the change in capital due to operations.

Form 1(a) shows Henry Brown's comparative financial condition graphically.

Form 1(b) shows a comparative graph of assets, liabilities, and capital.

Comparing Individual Assets and Liabilities.—The amount of increase or decrease in individual assets and liabilities during a period of time measures the net change between present and former condition of each item. It does not, however, show the *cause* of the change. Information of value in managing the business is thus not available.

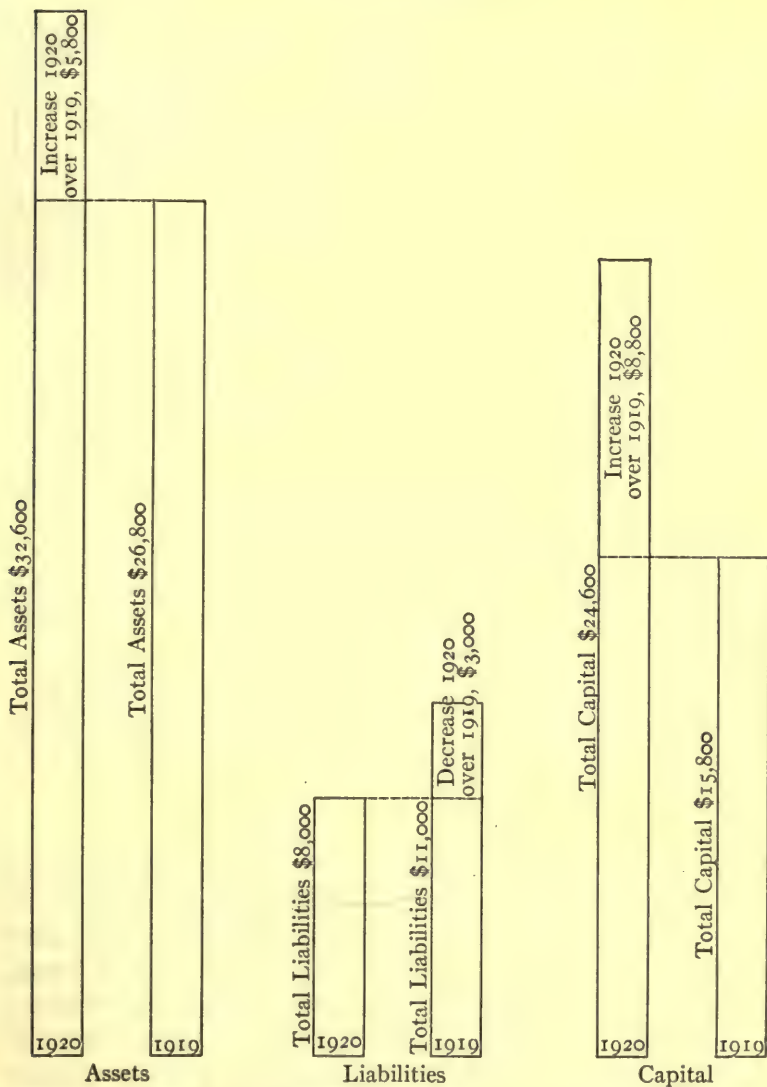
The decrease of \$800 in Cash in the Brown example shows the difference in condition of this asset, but it does not show what caused the change—it does not show the total cash received and what brought it in, nor the total cash disposed of and for what it was paid. Accounts Receivable and Notes Receivable both show increases, but additional information is necessary to know the cause. Merchandise affords no figures for purchases or sales



Henry Brown

Form 1. (a) Graph of Comparative Financial Condition

Scale: \$6,000 per inch



Henry Brown

Form I. (b) Comparative Graph of Total Assets, Liabilities, and Capital

Scale: \$6,000 per inch

	Summary
Increase of Assets.....	\$5,800
Decrease of Liabilities.....	3,000
Increase of Capital.....	<u>\$8,800</u>

Inc. of Assets \$5,800	+	Dec. of Liab. \$3,000
---------------------------	---	-----------------------------

equals

Increase of Capital \$8,800
--

of this asset. Accordingly, one cannot determine what profit, if any, has been made from dealing in merchandise unless additional data are given. Expense assets indicate that the proprietor owns \$100 less of these than the year before, but tell nothing as to the amount consumed during the year. In the case of Furniture and Fixtures there is nothing to indicate how much has been consumed and whether or not any part has been sold. In Real Estate there has been an increase of \$2,000, but this does not necessarily mean that the old property was improved to the extent of \$2,000. Perhaps all the 1919 real estate has been sold and new real estate purchased for \$12,000. A large profit or a loss may have been made on the sale of the old real estate. This information cannot be obtained from the statement. Some other means for obtaining it must be provided.

The schedules 1919 and 1920 of the liabilities, Accounts Payable, Notes Payable, and Mortgage Payable, show what each consisted of, but do not show all the changes that took place during the year.

Need for Additional Information.—In Chapter VI we learned that changes in capital result from changes in assets or liabilities, or both. Since a change in any asset or liability *may* affect capital, it is advisable to record all changes as they occur, and indicate the exact nature of the transactions bringing them about. The comparative financial statement fails to give this information, which is invaluable to a proprietor, and it must be secured. The best method of collecting and recording this additional information is presented in the chapters which follow.

QUESTIONS

1. What is the purpose of a comparative statement?
2. What form for a comparative statement do you prefer? Illustrate the form. Why do you prefer this form?
3. Why must net increases in assets and net decreases in liabilities be added to find increase in capital?
4. In what other way may the effect on capital be stated? Illustrate.
5. What information cannot be obtained from the statement of Henry Brown? Why?
6. Would a schedule showing what each asset and liability consists of give you the desired information?
7. How would you obtain the additional information?
8. Under which one of the five cases in Chapter VI showing increase in capital would you classify the comparative statement of Henry Brown on page 69?
9. Explain the probable cause of increase or decrease in each of the several assets and liabilities in Henry Brown's statement.
10. Refer to Henry Brown's statement on page 69. Assume that he contributed \$3,000 in cash during the year as an additional investment. Find the net profit.
11. Assume that Brown did not make an additional investment but withdrew \$2,000 for personal use. Find the net profit.
12. Find the profit if Brown invested \$4,000 and withdrew \$3,200 during the year.

PROBLEMS

NOTE.—From the information furnished in each of the following problems:

- (a) Prepare a comparative statement of assets, liabilities, and capital.
 - (b) Prepare bar graphs showing the amount of the several classes of assets and liabilities for each date.
 - (c) State which of the twelve possible changes in assets and liabilities each problem represents. (See Chapter VI.)
1. On June 30, 1920, John Kelly had \$2,000 in cash; merchandise, \$7,000; and other assets of \$8,000. He owed on account \$1,700; and on other liabilities \$2,300. June 30, 1921, his cash was \$1,400; merchandise, \$6,000; and other assets \$11,000. He owed on account \$1,800; and on other liabilities \$2,000.

Compare your statement with Henry Brown's statement on page 69.

2. March 31, 1921, Charles Stevens had cash \$1,200; accounts receivable \$1,700; merchandise \$4,000; and other assets \$8,000. He owed, on account, \$2,000; and on notes \$1,500. One month later, April 30, 1921, his cash was \$1,000; accounts receivable \$1,800; merchandise \$5,000; and other assets \$6,000. He owed, on account, \$1,000; and on notes \$1,100.

3. December 31, 1920, William Maxwell's financial condition was as follows: cash \$2,000; accounts payable \$3,000; merchandise \$6,000; notes payable \$2,500; accounts receivable \$2,800; expense items unconsumed \$125; rent paid in advance \$300; furniture and fixtures \$1,000. Six months later, June 30, 1921, an investigation of his financial condition disclosed these facts: merchandise \$7,500; accounts payable \$4,000; notes receivable \$1,000; cash \$1,700; notes payable \$1,500; unconsumed expense items \$75; accounts receivable \$3,000; furniture and fixtures \$900.

4. On September 30, 1921, Silas Webb's assets and liabilities were: cash \$1,740; merchandise \$6,200; accounts receivable \$2,200; accounts payable \$2,400; notes receivable \$3,000; notes payable \$2,500; unconsumed expense items \$150; real estate \$14,000, against which there was a mortgage payable of \$6,000; furniture and fixtures \$1,200. At the close of the preceding year, September 30, 1920, his assets and liabilities were: merchandise \$5,700; accounts payable \$2,100; accounts receivable \$2,900; cash \$1,910; notes payable \$2,000; expense items on hand \$100; real estate \$4,000; furniture and fixtures \$1,000.

5. The following statements show the financial condition of James W. McCarty on the dates indicated.

April 30, 1921

Assets:		Liabilities:	
Cash.....	\$1,000 -	Accts. Pay ...	\$4,400 -
Accts. Rec.....	3,100 -	Notes Pay....	2,300 -
Mdse.....	4,300 -	Total.....	\$6,700 -
Furn. & Fix.....	1,200 -	Capital:	
Expense.....	150 -	J. W. Mc-	
Rent.....	200 -	Carty's In-	
		vestment...	\$2,500 -
		Add: Profit...	750 -
		Total.....	3,250 -
	<u>\$9,950 -</u>		<u>\$9,950 -</u>

October 31, 1921

Assets:		Liabilities:	
Cash.....	\$1,900 -	Accts. Pay....	\$3,700 -
Accts. Rec.....	1,200 -	Notes Pay....	1,800 -
Notes Rec.....	1,600 -		
Mdse.....	4,000 -	Total.....	\$5,500 -
Furn. & Fix.....	1,150 -	Capital:	
Expense.....	100 -	J. W. Mc-	
		Carty's In-	
		vestment....	\$3,250 -
		Add: Profit...	1,200 -
		Total.....	4,450 -
	<u>\$9,950 -</u>		<u>\$9,950 -</u>

6. On June 13, 1920, Samuel Cohen had the following assets:

Goods on Hand.....	\$6,000 -
Cash.....	4,000 -
Due from Customers.....	5,000 -
Notes Receivable.....	3,000 -
Land.....	1,900 -
Total.....	<u>\$19,900 -</u>

His liabilities were:

Mortgage Payable.....	\$8,000 -
Notes Payable.....	4,000 -
Due to Creditors.....	3,000 -
Total.....	<u>\$15,000 -</u>

On June 13, 1921, he had:

Goods on Hand.....	\$5,000 -
Cash.....	2,500 -
Due from Customers.....	2,500 -
Land.....	2,000 -
Total.....	<u>\$12,000 -</u>

His liabilities were:

Mortgage Payable.....	\$8,000 -
Notes Payable.....	2,000 -
Due to Creditors.....	2,000 -
Total.....	<u>\$12,000 -</u>

7.

JOSEPH SMITH

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

March 31, 1920

Cash.....	\$ 1,500 -	Accounts Payable.....	\$ 1,500 -
Merchandise.....	5,000 -	Notes Payable.....	3,000 -
Accounts Receivable...	2,000	Mortgage Payable....	2,000 -
Notes Receivable.....	3,000 -	Total.....	\$ 6,500 -
Plant.....	5,000 -	J. Smith, Capital.....	14,000 -
Bonds.....	2,000 -		
Furniture and Fixtures.	2,000 -		
	<u>\$20,500 -</u>		<u>\$20,500 -</u>

JOSEPH SMITH

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

March 31, 1921

Cash.....	\$ 2,000 -	Accounts Payable.....	\$ 5,000 -
Merchandise.....	4,000 -	Notes Payable.....	2,000 -
Accounts Receivable...	3,000 -	Mortgage Payable....	5,000 -
Notes Receivable.....	4,000 -	Total.....	\$12,000 -
Plant.....	6,000 -	J. Smith, Capital.....	10,500 -
Bonds.....	2,000 -		
Furniture and Fixtures.	1,500 -		
	<u>\$22,500 -</u>		<u>\$22,500 -</u>

8. At the end of the year, December 31, 1920, Lorenz Brown had capital of \$10,000; cash in bank \$3,000; goods in stock \$4,000; customers owed him \$2,000; and he had notes on hand for \$1,000. He valued his building at \$7,000 and his furniture at \$3,000. His notes outstanding were \$5,000 and he owed his creditors \$5,000 on account.

A year later his cash in bank was \$2,500; goods on hand \$4,000; and customers owed him \$2,000. He valued his building at \$7,000 and his furniture at \$2,750. His notes outstanding amounted to \$4,000 and he owed his creditors \$5,250.

9.

MATHEW DOUGLAS

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

January 31, 1919

Cash.....	\$ 4,000 -	Notes Payable.....	\$ 4,000 -
Notes Receivable.....	3,000 -	Accounts Payable.....	10,000 -
Accounts Receivable...	4,000 -	Mortgage Payable.....	5,000 -
Real Estate.....	10,000 -	Math. Douglas, Capital	30,000 -
Merchandise.....	7,000 -		
Furniture and Fixtures.	5,000 -		
Machinery.....	16,000 -		
	<u>\$49,000 -</u>		<u>\$49,000 -</u>

MATHEW DOUGLAS

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

January 31, 1920

Cash.....	\$ 5,000 -	Notes Payable.....	\$ 7,000 -
Notes Receivable.....	6,000 -	Accounts Payable.....	16,000 -
Accounts Receivable...	5,000 -	Mortgage Payable.....	3,000 -
Real Estate.....	11,000 -	Math. Douglas, Capital	30,000 -
Merchandise.....	9,000 -		
Furniture and Fixtures.	4,000 -		
Machinery.....	16,000 -		
	<u>\$56,000 -</u>		<u>\$56,000 -</u>

CHAPTER VIII

DEVELOPMENT OF THE EQUATION

Purpose of Chapter.—

1. Basic equation used to record business transactions.
2. Development of the equation for this purpose.

Recording Increases and Decreases.—Since all change in capital is due to changes in assets and liabilities, all financial information will be obtained from the history of the increases and decreases in assets, liabilities, and capital. To obtain the causes of changes in capital, we record the causes of all changes in assets and liabilities, and then collect those cause records which have an effect on capital. A statement of assets and liabilities prepared at the beginning and at the end of a period shows financial condition on the two dates. This comparative statement tells nothing as to what has taken place between the two dates. Only a device that will enable one to record all changes in assets and liabilities *as they occur* will provide this information.

A succession of comparative statements, one for each day, might be used. While this would indicate the source of changes, it would prove cumbersome and would not show *total* increases and decreases in the individual assets and liabilities for a year or less—something that is of great value in managing a business.

The Device.—To develop a device that will meet the needs at all times, we shall begin with a simple statement of assets, liabilities, and capital, and show changes—increases and decreases—by the equation method, and then rearrange the equation so as to collect the data easily and effectively.

Transaction 1. Henry Dixon begins business with assets of \$5,000 and liabilities of \$1,000. This may be stated:

Assets.....	\$5,000
Liabilities.....	1,000
Capital.....	<u>\$4,000</u>

or

$$\text{Assets, \$5,000} - \text{Liabilities, \$1,000} = \text{Capital, \$4,000}$$

By rearranging the minus items the equation may be stated in positive terms, thus:

$$\text{Assets, \$5,000} = \text{Liabilities, \$1,000} + \text{Capital, \$4,000}$$

Transferring the minus item to the opposite side of the equality sign and adding it to the items on that side has the effect of subtracting it from the items on the side where it originally appeared.

To explain how the equation may be used to record all increases and decreases, assume that Dixon buys \$100 in merchandise for cash. The asset, merchandise, has been exchanged for the asset, cash. The effect of this transaction, the carrying out of a business deal with others, is shown in the following equation:

$$\text{Assets, \$5,000} + \text{Assets, \$100} - \text{Assets, \$100} = \text{Liabilities, \$1,000} + \text{Capital, \$4,000}$$

Stated in positive terms by transposing minus items—

$$\text{Assets, \$5,000} + \text{Assets, \$100} = \text{Liabilities, \$1,000} + \text{Capital, \$4,000} + \text{Assets, \$100}$$

Simplifying the equation, that is, collecting all items of the same kind, we have:

$$\text{Assets, \$5,000} = \text{Liabilities, \$1,000} + \text{Capital, \$4,000}$$

which leaves us just where we started. This is correct because Dixon merely exchanged one asset of \$100 for another of the same amount, leaving his total assets unchanged.

Changing the Form of the Equation.—While the horizontal equation affords a means of recording changes, it is cumbersome and does not lend itself readily to obtaining the totals of increases and decreases. A change in the arrangement of the equation provides for obtaining totals easily. Instead of the horizontal, use the vertical equation. The equality sign may be vertical and extended, thus:

(1) Assets.....	\$5,000		(1) Liabilities.....	\$1,000
			(1) Capital.....	4,000

The items marked (1) are the original assets, liabilities, and capital of Henry Dixon.

We shall now show how the vertical equation is used:

Transaction 2. Dixon's purchase of \$100 in merchandise for cash will be recorded as follows:

(1) Assets.....	\$5,000		(1) Liabilities.....	\$1,000
(2a) Assets.....	100		(1) Capital.....	4,000
			(2b) Assets.....	100

The increase in assets of \$100 due to the purchase of merchandise is shown by item (2a) on the left side, and the decrease in assets of \$100, due to the payment of cash is recorded as item (2b) on the right side of the equality sign. This has the effect of subtracting \$100 from the total assets of \$5,100 on the left side. As assets have increased \$100 and decreased \$100, there has been no change, and since liabilities remain the same, capital has not changed.

Transaction 3. Dixon paid \$500 of his liabilities in cash. The record will be:

(1) Assets.....	\$5,000	(1) Liabilities.....	\$1,000
(2a) Assets.....	100	(1) Capital.....	4,000
(3a) Liabilities.....	500	(2b) Assets.....	100
		(3b) Assets.....	500

The decrease in liabilities of \$500 (3a) is entered on the opposite side of the equality sign from the original liabilities of \$1,000 and thus has the effect of deducting that amount (\$500) from the liabilities. The decrease in assets of \$500 is entered as item (3b) on the side opposite the original assets and indicates a \$500 reduction in assets.

That these transactions have no effect on capital may be proved as follows:

Assets:

Original (left side of equation).....	\$5,000 -
Plus Increase (item 2a).....	100 -
Total.....	\$5,100 -
Less: Decrease (items 2b and 3b).....	600 -
Equals assets now owned.....	\$4,500 -

Liabilities:

Original (right side of equation).....	\$1,000 -
Less: Decrease (item 3a).....	500 -
Equals liabilities now owed.....	500 -

Capital:

Original (right side of equation).....	\$4,000 -
Plus increase and minus decrease.....	0 -
Equals Present Capital.....	\$4,000 -

The amount of the present capital, \$4,000, can be verified by deducting the total liabilities of \$500 from the total assets of \$4,500.

Improving the Equation.—The equation may be improved by allowing more space for each group, assets, liabilities, and capital, and assigning to each a definite part of the equality sign.

(1) Assets.....	\$5,000	(2b) Assets.....	\$ 100
(2a) Assets.....	100	(3b) Assets.....	500
(3a) Liabilities.....	500	(1) Liabilities.....	1,000
		(1) Capital.....	4,000

The method of recording all changes in each group may be indicated as follows:

Assets:			
	<i>Increases</i>		<i>Decreases</i>
		Liabilities:	
	<i>Decreases</i>		<i>Increases</i>
		Capital:	
	<i>Decreases</i>		<i>Increases</i>

Final Form of the Equation.—We observe that increases in a group are always on the same side of the equality sign as the original group and decreases always on the side opposite the original group. Since the name of the group, i.e., asset, liability, or capital, indicates the side on which increases or decreases will be written, it is more convenient to write the name of the group in the center, across the equality sign. The final form of the equation is shown below:

	ASSETS	
<i>Increases</i>		<i>Decreases</i>
	LIABILITIES	
<i>Decreases</i>		<i>Increases</i>
	CAPITAL	
<i>Decreases</i>		<i>Increases</i>

The effect of recording an amount on either side of the equality sign may be summarized as follows:

SUMMARY OF INCREASES AND DECREASES IN ASSETS, LIABILITIES, AND CAPITAL

An amount entered on the left side must show one or more of the following:

Increase in Assets
Decrease in Liabilities
Decrease in Capital

An amount entered on the right side must show one or more of the following:

Decrease in Assets
Increase in Liabilities
Increase in Capital

The New Equation in Use.—How Henry Dixon's transactions may be recorded in this new form of equation is shown below:

1. Henry Dixon begins business with assets of \$5,000 and liabilities of \$1,000.
2. He buys \$100 in merchandise for cash.
3. He pays \$500 of his liabilities in cash.

Each transaction is numbered as above and should be traced into the equation.

ASSETS			
<i>Increases</i>		<i>Decreases</i>	
(1)	\$5,000	(2)	\$100
(2)	100	(3)	500
LIABILITIES			
<i>Decreases</i>		<i>Increases</i>	
(3)	\$ 500	(1)	\$1,000
CAPITAL			
<i>Decreases</i>		<i>Increases</i>	
		(1)	\$4,000

Summarizing this information we find:

Assets (excess of increases over decreases).....	\$4,500
Liabilities (excess of increases over decreases).....	500
Capital (excess of increases over decreases).....	<u>\$4,000</u>

The capital is also found by subtracting liabilities from assets, in accordance with the simple basic equation, $A - L = C$. Comparing the present with the original capital we find that no change has occurred, because none of the transactions affected capital.

Recording Transactions Affecting Capital.—It was shown in Chapter VI that capital *increases* if assets increase and *decreases* if assets decrease, liabilities remaining the same. There are other causes of change in capital, but these two will be sufficient for our purpose at present.

Transaction 1. John Smith begins business with assets—cash, merchandise, etc.—of \$6,000. With the investment of his assets in the business the equation becomes:

$$\text{Assets, \$6,000} = \text{Liabilities, \$0} + \text{Capital, \$6,000}$$

See items marked (1) in the equation on page 87.

Transaction 2. Smith sells merchandise that cost him \$2,000 for \$3,000 cash. There has been an increase of \$3,000 in the asset, cash (see item 2a), and only a \$2,000 decrease in the asset, merchandise (see item 2b). Expressed in general terms, i.e., not using individual names, assets are now \$7,000 ($\$6,000 + \$3,000 - \$2,000$), the excess of increases over decreases, and since liabilities have not changed, there must be an increase in capital of \$1,000 (see item 2c).

Transaction 3. During the period Smith purchased for cash the right to use the building (rent), postage, stationery, clerks' services, etc., to the amount of \$700. This exchange of the asset, cash, for other assets recorded in general terms, results in an increase in assets of \$700 (item 3a) and a decrease of \$700

(item 3b), causing no change in capital, for neither assets nor liabilities have changed.

Transaction 4. At the end of a month it is found that \$500 of the assets, right to use the building, postage, stationery, clerks' services, etc., were consumed during the period. There has been a decrease in assets of \$500 (item 4b), and since liabilities have not changed, capital must have decreased \$500 (item 4a) as well.

ASSETS			
<i>Increases</i>		<i>Decreases</i>	
(1)	\$6,000	(2b)	\$2,000
(2a)	3,000	(3b)	700
(3a)	700	(4b)	500
LIABILITIES			
<i>Decreases</i>		<i>Increases</i>	
CAPITAL			
<i>Decreases</i>		<i>Increases</i>	
(4a)	\$ 500	(1)	\$6,000
		(2c)	1,000

The equation may be summarized as follows:

Assets (excess of increases over decreases)	\$6,500
Liabilities (excess of increases over decreases)	0
Capital (excess of increases over decreases)	<u>\$6,500</u>

The capital is verified by subtracting the liabilities from the assets.

While this form of the equation is excellent for indicating the effect of transactions on the basic groups, assets, liabilities, and capital, it is not adapted to recording in detail the many different transactions that take place daily. The next chapter will show how the equation may be adapted to meet this requirement.

In whatever final form the record of business transactions is to be made, however, the student must always think in terms of assets, liabilities, and capital. If he cannot indicate the effect of every transaction in this way, he is not prepared for the work that follows and should carefully review this chapter.

QUESTIONS

1. What causes change in capital?
2. How can the sources of change in capital be obtained?
3. How can the financial condition of a business be determined?
4. Describe a device that will enable one to indicate all changes in assets, liabilities, and capital.
5. How may subtraction be indicated in an equation without using the minus sign?
6. (a) What is a transaction?
(b) Give one that affects only assets.
(c) Give one that affects assets and liabilities.
(d) Give one that affects assets and capital.
7. What is the best form of equation for accounting? Why?
8. Prepare a summary of increases and decreases.
9. On which side of the equation does excess of assets appear? Liabilities? Capital?
10. Jones begins business with \$4,000 in cash. How would you record this in the vertical equation?

PROBLEMS

1. (a) Record the following data in a vertical equation under the general headings of Assets, Liabilities, and Capital. Place the figures 1, 2, 3, 4 opposite the items to which they apply in the equation.
(b) From the equation prepare a summarized statement of assets, liabilities, and capital.
 1. Charles Black began business with assets of \$5,000.
 2. He bought merchandise for cash \$2,000.
 3. He bought merchandise on account \$1,000.
 4. He paid \$400 in cash on his debt (item 3).
2. (a) Record in an equation; (b) prepare a summarized statement.
 1. C. C. Hughes began business with \$6,000 in assets.
 2. He paid \$200 in cash for 1 month's rent in advance.

3. He bought merchandise for cash \$2,000.
4. He bought store fixtures, on account, \$1,000.
5. He sold merchandise that cost him \$1,000 for \$1,500 in cash.
6. He paid cash for stamps, stationery, advertising, clerks' salaries, etc., total \$300.
7. The end of the month has arrived and we find that all the rent (item 2) \$200, and one-half of stamps, etc. (item 6) \$150, have been consumed, total \$350.
3. (a) Record in an equation; (b) prepare a summarized statement.
1. M. S. King began business with assets of \$10,000 and liabilities of \$3,000.
2. Bought merchandise, on account, \$2,000.
3. Paid cash for rent \$300.
4. Bought merchandise for cash \$1,000.
5. Bought furniture and fixtures for store use paying cash \$1,000.
6. Paid \$500 in cash on merchandise bought on account (item 2).
7. Sold merchandise that cost \$1,500 for \$2,000 in cash.
8. Bought merchandise, on account, \$1,200.
9. Paid \$400 in cash for miscellaneous expenses, such as postage, clerks' salaries, electric light, telephone, etc.
10. Paid \$1,000 in cash on original liabilities (item 1).
11. All of item 3 and one-half of item 9 was consumed.
4. (a) Record in an equation; (b) prepare statement.
1. C. E. Rogers began business with cash \$3,000; merchandise \$4,000; store and lot \$10,000. He owed to R. D. Brand, on account, \$1,000.
2. Paid \$200 in cash for a cash register.
3. Sold merchandise that cost \$1,000 to D. E. Cutler for \$1,500 in cash.
4. Sold merchandise that cost \$1,500 to L. F. Foster for \$2,200 on account.
5. Paid \$500 in cash for miscellaneous expenses.
6. Bought merchandise from Burns and Company, on account, \$2,000.
7. Paid R. D. Brand cash for amount owed, on account, \$1,000 (item 1).
8. Received check for \$1,200 from L. F. Foster in part settlement of what he owes on account (item 4).
9. All miscellaneous expenses were consumed, total \$500 (item 5).
10. Burglars stole merchandise stock estimated at cost \$200.
5. (a) Record in an equation; (b) prepare statement.
1. Ralph Horton began business with cash \$2,000; merchandise \$7,000; furniture and fixtures \$1,200; accounts receivable \$3,000. He owed to W. H. Harding, on account, \$800, and owed on a note in favor of F. B. Willis \$1,200.

2. Paid Star Safe Company \$800 in cash for office safe.
 3. Sold to Hiram Johnson, on account, for \$3,000 merchandise that cost \$2,000.
 4. Bought from Sensible Shoe Company merchandise \$3,000 and gave them his note payable in 30 days in full payment.
 5. Sold merchandise for cash \$4,500 (cost \$2,500).
 6. Paid cash for clerks' salaries; Charles Robins \$50 and Harry Norton \$60.
 7. Bought from Kushion Kar Company truck for delivery purposes \$1,500. Paid them \$500 in cash and gave his note for the balance.
 8. Paid cash for stationery, advertising, etc., \$300.
 9. Received cash on accounts receivable \$3,000. (See item 1.)
 10. Paid F. B. Willis in cash for note payable \$1,200. (See item 1.)
 11. Bought merchandise from Ryan and Company \$1,600. Paid them one-half cash, balance on account.
 12. Paid River Realty Company cash for rent \$300.
 13. Paid the Sensible Shoe Company cash for 30-day note given them in item 4, \$3,000.
 14. The following assets have been consumed in operating the business: all clerks' salaries \$110 (item 6); from item 8, stationery, advertising, etc., \$200; one-half the rent \$150 (item 12).
6. (a) Record in an equation; (b) prepare statement.
1. Silas Marner began business with the following assets and liabilities: cash \$1,100; delivery equipment \$2,000; furniture and fixtures \$1,000; merchandise \$6,000; accounts payable \$700; notes payable \$500.
 2. Paid Triangle Renting Company cash for rent in advance \$300.
 3. Sold to James P. Sutton, terms one-half cash, balance on account, merchandise \$3,000. This merchandise cost \$1,800.
 4. Bought from Underhill and Dodge merchandise \$2,500, terms \$500 in cash, balance on account.
 5. Paid all of accounts payable \$700 in cash. (See item 1.)
 6. Proprietor withdrew \$100 in cash for his personal use.
 7. Sold merchandise that cost \$1,700 for \$3,100 in cash.
 8. Paid cash for miscellaneous expenses \$175.
 9. Received from James P. Sutton his 30-day note in full payment of the balance due on item 3.
 10. Gave the note received from Mr. Sutton (see item 9) to Underhill and Dodge to apply on account.
 11. The following assets were consumed in conducting the business: rent \$200 (item 2); miscellaneous expenses \$125 (item 8).

7. (a) Record in an equation; (b) prepare statement.

1. Gilbert Larabee began business with the following assets and liabilities: merchandise \$4,000; cash \$1,000; real estate \$10,000; furniture and fixtures \$500; mortgage payable \$2,000; accounts payable \$2,500.
2. Sold to Frank Hees for cash, merchandise for \$200 which cost \$160.
3. Sold to Glen Freed, on account, merchandise for \$175 which cost \$100.
4. Paid cash on accounts payable \$500. (See item 1.)
5. Received from Glen Freed cash, on account, \$100. (See item 3.)
6. Sold to George Frederickson merchandise for \$800 which cost \$500.
Received Mr. Frederickson's note for same.
7. Paid cash on accounts payable \$500. (See item 1.)
8. Bought merchandise of \$400 from Leslie Nash on account.
9. Paid salaries of \$125 and miscellaneous expense \$50.
10. Salaries and miscellaneous expense in item 9 were consumed in conducting the business.

8. (a) Record in an equation; (b) prepare statement.

1. Benjamin Mobach started business with cash \$10,000.
2. Bought for cash furniture and fixtures from Stern Brothers to the amount of \$1,000.
3. Paid cash for rent of storeroom \$125.
4. Bought merchandise from Bushman and Dyne amounting to \$3,000, for which he paid \$1,000 in cash and gave his 30-day note for the balance.
5. Paid \$8 for freight and cartage on merchandise.
6. Paid \$2,000 cash for a delivery truck.
7. Sold to Franklin Whitwell for cash \$1,400, merchandise which cost \$1,000.
8. Sold to Martin Flagg, on account, for \$700, merchandise which cost \$520.
9. Paid \$15 for miscellaneous expenses.
10. Paid his 30-day note of \$2,000. (See item 4.)
11. Martin Flagg returned goods for which he was originally charged \$50.
This merchandise cost \$40.
12. The following assets were consumed in conducting the business: rent \$125 (item 3); miscellaneous expense \$15 (item 9).

9. (a) Record in an equation; (b) prepare statement.

1. Joe Ebel began business with the following assets and liabilities: merchandise \$5,000; cash \$1,500; furniture and fixtures \$600; accounts payable \$800; note given to Charles Hood \$300.

2. Rent for storeroom paid in cash for one month in advance \$300.
3. Paid \$5 for installation of telephone.
4. Sold merchandise to Oscar Hervey on account \$200. This merchandise cost \$130.
5. Sold merchandise that cost \$1,400 to Clarence Lavender for \$2,500 cash.
6. Paid cash for clerks' salaries: Ned Payne \$30; Frank Sweeney \$40; and Lorel Hadigan \$45.
7. Bought from the Surety Safe Company an office safe for \$500. Gave note for \$400 and cash for the balance.
8. Oscar Hervey returned merchandise for which he was originally charged \$50. Cost of it was \$42. (See item 4.)
9. Bought merchandise, on account, from Gamble and Star \$375.
10. Paid cash for light and heat \$25.
11. Oscar Hervey paid \$125 on his account. It is impossible to collect the remaining \$25. (See item 4.)
12. Returned merchandise to the amount of \$75 to Gamble and Star.
13. Mr. Ebel was robbed of \$80 while taking it to the Wabash Bank.
14. Items consumed in conducting the business: rent \$300 (item 2); salaries \$115 (item 6); light and heat \$25 (item 10).

10. (a) Record in an equation; (b) prepare statement.

1. Bevan Townsend opened a grocery store with the following assets and no liabilities: merchandise \$800; cash \$400; building and lot \$4,500.
2. Sold for cash, merchandise for \$115 which cost \$75.
3. Sold on account to Mrs. Luella Butler, merchandise which cost \$7 for \$9.
4. Bought a cash register for \$75. Gave his 30-day note in payment.
5. Paid Johnny Dunn, delivery boy, wages of \$7.
6. Paid for stationery, postage, etc., \$3.
7. Mrs. Luella Butler returned goods that were spoiled amounting to \$3. Cost \$2.20 (item 3).
8. Bought merchandise on account from Kroger and Company \$100.
9. Paid Aaron Maxwell \$4 for fresh strawberries.
10. Sold the strawberries of item 9 to Andy Fink for \$5 cash.
11. Paid miscellaneous expense of \$12.
12. Mrs. Luella Butler paid her account in full \$6. (See items 3 and 7.)
13. Assets consumed amount to \$22. (See items 5, 6, and 11.) Spoiled goods destroyed \$2.20 (item 7).

11. (a) Record in an equation; (b) prepare statement.

1. Clarence Hussey opened business with the following assets and liabilities: merchandise \$9,000; cash \$1,800; furniture and fixtures \$700; delivery car \$1,800; real estate \$20,000; investments in stocks and bonds \$2,500; office stationery \$16; gasoline for car \$9; accounts payable \$3,000; notes payable \$5,000; mortgage on real estate \$6,000.
2. Paid cash for miscellaneous expense \$45.
3. Sold, on account to Lemuel Kastor merchandise which cost \$1,200 for \$2,000.
4. Sold to Paul Miller merchandise costing \$900 for \$1,500 Received \$500 cash and two notes for \$500 each.
5. Lemuel Kastor returned merchandise to the amount of \$500. Cost \$400 (item 3).
6. Paid \$1,500 cash on accounts payable and gave 60-day note for \$1,500 (item 1).
7. Received \$35 cash for rent of part of the office.
8. Paid \$6 to Nathaniel Hathaway for garage rent.
9. Lemuel Kastor paid his account in full \$1,500 cash (items 3 and 5).
10. Assets consumed: gasoline \$6 (item 1); wear on the car \$50 (item 1); miscellaneous expense \$20 (item 2); garage rent \$6 (item 8).

CHAPTER IX

EXPANSION BY SUBSTITUTION

Purpose of Chapter.—

1. Substitution of individual for group titles in the equation of assets, liabilities, and capital.
2. Preparation of a statement of assets, liabilities, and capital, using individual titles.

Reason for Expansion.—The primary purpose of expansion is to provide information. Financial condition on a given date is determined by means of a statement of assets, liabilities, and net worth, or capital. This information is useful in *managing* a business, but it is of greater value to know what is happening from day to day, since these operations show the *movement* of the business, how it is thriving, its success or failure. Past events in history explain present conditions and aid in determining the future policies of nations. So also the past operations of an enterprise indicate the cause of its present condition and point the way to financial and operating policies most likely to produce the best results in the future.

Information concerning daily operations is obtained by expanding the group divisions of the equation. The different kinds of assets are separated into such groups as cash, accounts receivable, merchandise, etc.; liabilities, into accounts payable, notes payable, etc.; and capital into, John Jones, Capital, etc.

Expanding by Substitution.—Heretofore the general terms, assets, liabilities, and capital have been used to record increases and decreases. Now by substituting for the general terms the

names of the individual assets and liabilities we can find the individual increases and decreases. The student must, however, always think first of the effect on the group, asset, liability, or capital, and then substitute for the group title the individual asset, liability, or capital title. The same form of equation will be used no matter how great the expansion. For example:

Transaction 1. John Smith begins business with \$5,000 in cash. Recording this in general terms, we have:

ASSETS		
<i>Increases</i>		<i>Decreases</i>
(1).....	\$5,000	
LIABILITIES		
<i>Decreases</i>		<i>Increases</i>
	(1) None.....	0
CAPITAL		
<i>Decreases</i>		<i>Increases</i>
	(1).....	\$5,000

By substituting the names of the individual asset and the person whose capital has been affected, the equation appears as follows:

CASH ~~ASSETS~~		
<i>Increases</i>		<i>Decreases</i>
(1).....	\$5,000	
~~LIABILITIES~~		
<i>Decreases</i>		<i>Increases</i>
	(1) None.....	0
JOHN SMITH'S CAPITAL ~~CAPITAL~~		
<i>Decreases</i>		<i>Increases</i>
	(1).....	\$5,000

Since the name "Cash" indicates that it is an asset, we enter the increase under that title, and, applying the same reasoning to capital, we enter its increase under the name of "John Smith's Capital." Since liabilities have not been affected we omit that title. The following equation indicates what took place:

CASH			
<i>Increases</i>			<i>Decreases</i>
(1).....	\$5,000		
JOHN SMITH'S CAPITAL			
			<i>Increases</i>
		(1).....	\$5,000

Additional transactions expand the equation as follows:
Transaction 2. Smith buys merchandise for cash \$3,000.

CASH			
<i>Increases</i>			<i>Decreases</i>
(1).....	\$5,000	(2).....	\$3,000
MERCHANDISE			
			<i>Decreases</i>
(2).....	\$3,000		
JOHN SMITH'S CAPITAL			
<i>Decreases</i>			<i>Increases</i>
		(1).....	\$5,000

Since this is merely an exchange of assets we have a decrease in the asset, Cash, of \$3,000 (item 2) and an increase in the asset, Merchandise, of \$3,000 (item 2). The entry of \$3,000 on the left side indicates an increase of that amount in the asset, Merchandise. We now have two assets aggregating \$5,000—Cash, \$2,000 (\$5,000—\$3,000), and Merchandise, \$3,000. The plan of expansion is simply to add the names of the individual assets and liabilities affected through increases and decreases.

Transaction 3. Smith sells merchandise that cost \$1,400 to Henry Hall on account for \$2,000. The equation now appears:

		CASH			
<i>Increases</i>				<i>Decreases</i>	
(1).....	\$5,000			(2).....	\$3,000
		MERCHANDISE			
<i>Increases</i>				<i>Decreases</i>	
(2).....	\$3,000			(3).....	\$1,400
		ACCOUNTS RECEIVABLE			
<i>Increases</i>				<i>Decreases</i>	
(3) H. Hall.....	\$2,000				
		JOHN SMITH'S CAPITAL			
<i>Decreases</i>				<i>Increases</i>	
				(1).....	\$5,000
				(3).....	600

This transaction has an effect on two assets and on capital. The asset, Accounts Receivable (claims against others), has been increased \$2,000 (item 3) and is entered on the left under that title, Hall's name being written in to indicate who owes Smith. The asset, Merchandise, has been decreased \$1,400 (item 3), the cost of the goods sold. Therefore that amount is entered on the right side under the title, Merchandise. Capital has been increased \$600 (item 3), the difference between the increase and decrease in assets (\$2,000—\$1,400), which is indicated by writing \$600 on the right under John Smith's Capital. In other words, the total assets are now \$5,600 (Cash, \$2,000 + Merchandise \$1,600 + Accounts Receivable, \$2,000) and since the liabilities are zero, the capital must be the difference, or \$5,600, an increase of \$600.

Transaction 4. Smith sells merchandise that cost \$1,000 for \$1,500 in cash.

Transaction 5. He pays \$500 in cash for various supplies for use in operating the business. The equation is again expanded:

CASH			
<i>Increases</i>		<i>Decreases</i>	
(1).....	\$5,000	(2).....	\$3,000
(4).....	1,500	(5).....	500
MERCHANDISE			
<i>Increases</i>		<i>Decreases</i>	
(2).....	\$3,000	(3).....	\$1,400
		(4).....	1,000
ACCOUNTS RECEIVABLE			
<i>Increases</i>		<i>Decreases</i>	
(3) H. Hall.....	\$2,000		
EXPENSE			
<i>Increases</i>		<i>Decreases</i>	
(5).....	\$ 500		
JOHN SMITH'S CAPITAL			
<i>Decreases</i>		<i>Increases</i>	
		(1).....	\$5,000
		(3).....	600
		(4).....	500

Transaction 4 increases the asset, Cash, \$1,500 and decreases the asset, Merchandise, \$1,000, the cost of the goods sold, causing an increase in capital of \$500. The same reasoning applies as in transaction 3. Transaction 5 results in a decrease of \$500 in the asset, Cash, and an increase of \$500 in the asset, Supplies to be Consumed in Conducting the Business, classified under the title, Expense (item 5).

Transaction 6. Buys \$2,000 worth of merchandise from Paul Brown on account.

Transaction 7. During the month \$200 of various assets

included under Expense were consumed in operating the business.

The equation now shows:

CASH			
<i>Increases</i>		<i>Decreases</i>	
(1).....	\$5,000	(2).....	\$3,000
(4).....	1,500	(5).....	500
MERCHANDISE			
<i>Increases</i>		<i>Decreases</i>	
(2).....	\$3,000	(3).....	\$1,400
(6).....	2,000	(4).....	1,000
ACCOUNTS RECEIVABLE			
<i>Increases</i>		<i>Decreases</i>	
(3) H. Hall.....	\$2,000		
EXPENSE			
<i>Increases</i>		<i>Decreases</i>	
(5).....	\$500	(7).....	\$200
ACCOUNTS PAYABLE			
<i>Decreases</i>		<i>Increases</i>	
		(6) Paul Brown.....	\$2,000
JOHN SMITH'S CAPITAL			
<i>Decreases</i>		<i>Increases</i>	
(7).....	\$200	(1).....	\$5,000
		(3).....	600
		(4).....	500

In transaction 6 an increase of \$2,000 in the asset, Merchandise, is recorded on the left, under the Merchandise title, and an increase in liabilities of \$2,000 in the amount Smith owes on the right side under the title, Accounts Payable. The name of Paul Brown is written before this amount to show to *whom* Smith owes it. Number 7 is recorded on the right of Expense to show

that these assets have decreased \$200, and on the left of John Smith's Capital to show that his capital has decreased \$200. The difference between total assets and liabilities is now \$200 less than before, and is reflected in the capital decrease of \$200.

Preparing Statements.—The statements are merely summaries of the information appearing in the equation. To obtain the information easily, all new titles for assets, such as Cash, Merchandise, Accounts Receivable, and Expense, are now placed in the asset division of the equation. This plan is also followed in the expansion of the liability and capital groups.

From the information contained in the equation the *financial condition* of John Smith on March 31¹ and the *sources* of the *change in his capital* are set forth in the following statements:

JOHN SMITH

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

March 31, 19—

Assets:		
Cash (excess of increases over decreases)	\$3,000 —	
Merchandise (excess of increases over decreases)	2,600 —	
Accounts Receivable (excess of increases over decreases)	2,000 —	
Expense (excess of increases over decreases) ..	<u>300 —</u>	
Total		\$7,900 —
Liabilities:		
Accounts Payable (excess of increases over decreases)	<u>\$2,000 —</u>	
Total		<u>2,000 —</u>
Capital:		
John Smith's Capital (excess of increases over decreases)	<u>\$5,900 —</u>	
Total		<u>\$5,900 —</u>

¹ In the illustration it is assumed that Smith began business March 1, 19—, and has been operating one month.

STATEMENT SHOWING SOURCES OF INCREASES AND DECREASES IN CAPITAL

Increases:	
Profit on sale of merchandise (item 3).....	\$600 -
" " " " " (item 4).....	<u>500 -</u>
Total.....	\$1,100 -
Decreases:	
Expense assets consumed (item 7).....	<u>\$200 -</u>
Total.....	200 -
Net Increase in Capital.....	\$ 900 -

Investment, March 1, 19—	\$5,000 —
Add Net increase in Capital as above	900 —
Capital, March 31, 19—	<u>\$5,900 —</u>

QUESTIONS

1. What is the purpose of expanding the equation?
2. What do the past operations of a business indicate?
3. How can information concerning its past operations be used in the management of the business?
4. Explain "expansion by substitution."
5. Under what conditions can changes in assets occur without changing capital?
6. (a) Explain the effect on assets, liabilities, and capital of a sale of merchandise for more than its cost.

- (b) How would you record this in the equation?
- 7. (a) Why is the title, Expense, used in the expanded equation?
(b) Name five items you would classify under Expense.
- 8. Prove that assets consumed in operating a business result in a decrease in capital.
- 9. (a) Explain three ways of producing decreases in capital.
(b) Give a transaction illustrating each.
- 10. (a) Explain three ways of producing increases in capital.
(b) Give a transaction illustrating each.
- 11. How can the present capital of a business be verified?
- 12. What information is contained in the statement explaining the capital?

PROBLEMS

- 1. James Gaffney began business with \$4,000 in cash.
 - (a) Record in the vertical equation, using the general titles, Assets, Liabilities, and Capital.
 - (b) Cross out the general terms and substitute the individual titles.
- 2. (a) Record in vertical equation, using general titles only.
(b) Record in another vertical equation, using the individual titles instead of the general titles.
- 1. Fred Warren began business with the following: cash \$2,000; accounts receivable \$1,500; merchandise \$6,000.
- 2. Bought merchandise for cash from A. H. Hill \$1,000.
- 3. Sold to William P. Richards, on account, merchandise that cost \$2,500 for \$3,100.
- 4. Received cash from all the old accounts receivable \$1,500.
- 5. Bought merchandise from R. T. Dunn, on account, \$1,700.
 - 3. (a) Record in vertical equation, using general titles only.
(b) Record in another vertical equation, using the individual titles instead of the general titles.
- 1. Ralph Rowland began business with the following assets and liabilities: cash \$1,800; merchandise \$5,000; accounts receivable \$1,500; accounts payable \$1,200.
- 2. Bought for cash furniture and fixtures \$700.
- 3. Sold merchandise to Alexander Walker, on account, \$2,800 (cost \$2,000).
- 4. Received cash from all the old accounts receivable \$1,500.

5. Paid in cash the accounts payable \$1,200.
6. Received cash from Alexander Walker, on account, \$1,500.
7. Sold merchandise that cost \$1,200 for \$1,700 in cash.
 4. (a) Record in vertical equation under general titles.
 - (b) Record in vertical equation, using individual titles.
 - (c) Prepare a statement of assets, liabilities, and capital from information in (b).
 - (d) Prepare a statement showing sources of increases and decreases in capital from information in (b). Assume a period of 1 month.
1. James D. Hackett began business, June 1, 19—, with the following assets and liabilities: cash \$2,000; merchandise \$7,000; furniture and fixtures \$1,000; due from H. C. Thompson, on account, \$800. He owed Ralph P. Blake, on account, \$1,100.
2. Sold merchandise that cost \$2,000 to William Boyce, on account, for \$2,800.
3. Paid \$400 in cash for various supplies to be used in operating the business.
4. Paid Ralph P. Blake in cash \$1,100 in full of account (item 1).
5. Sold merchandise to A. F. Watson, on account, for \$1,700 (cost \$1,200).
6. Received cash from William Boyce \$2,800. (See item 2.)
7. During the month \$150 of the supplies purchased as item 3 were consumed in operating the business.
5. See instructions for Problem 4.
1. Frank Dixon began business May 1, 19—, with the following assets and liabilities: merchandise \$2,000; cash \$3,500; Scott Marmion owes him, on account, \$650; furniture and fixtures \$825; he owed Don Byron \$700 on account, and Jacob Coleridge \$550 on a note.
2. Paid rent of \$150 in cash.
3. Sold merchandise that cost \$650 to Harold Chatterton for \$900 on account.
4. Paid \$65 for office supplies.
5. Received \$350 from Scott Marmion on account (item 1).
6. Paid Don Byron's entire account \$700 (item 1).
7. During the month all of the rent of \$150 was consumed and \$20 of the office supplies (items 2 and 4).
6. See instructions for Problem 4.
1. L. D. Hergot started business June 1, 19—, with the following assets and liabilities: cash \$10,000; merchandise \$8,000; land and building

\$25,000; furniture and fixtures \$1,200; due from George Moon \$950.

He owed Henry Owens \$2,000 and Richard Haynes \$1,200 on account.

2. Sold to Leslie Goldman, on account, merchandise that cost \$2,000, for \$3,200.
3. Received check for \$500, on account, from George Moon (item 1).
4. Returned merchandise of \$650 to Henry Owens (item 1).
5. Paid miscellaneous expense of \$175.
6. Theft of \$275 cash.
7. Sold to M. N. Bridges merchandise that cost \$1,050, for \$1,725 cash.
8. Paid Richard Haynes cash \$600 on account (item 1).
9. During the month all of the miscellaneous expense was consumed. \$175 (item 5).

7. (a) Record in vertical equation, using individual titles.

(b) Prepare a statement of assets, liabilities, and capital from information in (a).

(c) Prepare a statement showing sources of increases and decreases in capital from information in (a). Assume a period of 1 month.

1. James Harrison started business July 1, 19—, with the following assets and liabilities: cash \$6,000; merchandise \$8,250. He owed Lawrence Monroe, on account, \$3,700.
2. Paid rent of \$185.
3. Bought a delivery car for \$1,275 cash.
4. Sold merchandise that cost \$2,000 for \$3,050 cash.
5. Paid Lawrence Monroe one-half of his account, \$1,850, and gave him a 30-day note for the balance (item 1).
6. During the month all of the rent was consumed in operating the business (item 2).

8. See instructions for Problem 7.

1. R. V. Montgomery started business August 1, 19—, with \$10,000 cash.
2. Bought merchandise of \$5,000, on account, from William Ferris.
3. Bought furniture and fixtures of \$1,000, on account, from Roy Bauman.
4. Paid \$200 cash for rent.
5. Sold merchandise that cost \$1,200 to Carl Coan, on account, for \$1,675.
6. Sold merchandise that cost \$425 for \$600 cash.
7. Paid \$135 cash for office supplies.
8. Carl Coan returned merchandise of \$500 as unsatisfactory. Cost of this merchandise was \$300.
9. Paid cash for insurance on merchandise \$60.

10. The following assets were consumed in conducting the business: rent \$200 (item 4); \$50 of office supplies (item 7); \$5 of insurance (item 9).

9. See instructions for Problem 7.

1. Browne Elwell started business September 1, 19—, with the following assets and liabilities: land and buildings \$20,000; merchandise \$10,000; delivery equipment \$2,000; due from Mathew Schleger \$1,500 on account. He owed Arnold Bennett, on account, \$600; owed Leonard Woodson \$10,000 on a note. He had cash of \$6,000.
2. Paid miscellaneous expenses of \$350.
3. Sold merchandise that cost \$2,000 to Frank Cox, on account, for \$3,200.
4. Paid Arnold Bennett in full \$600 (item 1).
5. Paid salaries of \$325.
6. Bought an office safe for \$525 cash.
7. Received check from Frank Cox for \$3,150. Remainder of account, \$50, is uncollectible (item 3).
8. Purchased furniture and fixtures from Laswell and Son, on account, for \$1,300.
9. Mathew Schleger paid one-half of his account, \$750 in cash (item 1).
10. During the month the following assets were consumed in conducting the business: \$40 of delivery equipment (item 1); all of the miscellaneous expenses \$350 (item 2); all of the salaries \$325 (item 5).

10. See instructions for Problem 7.

1. David Sprague started business October 1, 19—, with the following assets and liabilities: merchandise \$6,000; cash \$3,000; furniture and fixtures \$900. He owed Judas Bullock \$500 on account and had on hand miscellaneous supplies of \$300.
2. Sold merchandise that cost \$1,000 to Morris Terry for \$1,700 cash.
3. Returned merchandise of \$250 to Judas Bullock and paid the remainder of his account in cash (item 1).
4. A fire destroyed \$300 of furniture and fixtures. No insurance.
5. Bought new furniture and fixtures of \$400, on account, from Mason Butler.
6. Sold merchandise that cost \$800 for \$1,250 cash.
7. Paid salaries to John Newman \$78, Fred Kates \$95, and Richard Flagg \$125.
8. During the month the following assets were consumed: miscellaneous supplies of \$200 (item 1); all salaries \$298 (item 7).

11 See instructions for Problem 7.

1. William Coolidge started business November 1, 19—, with the following assets and liabilities: merchandise \$6,500; cash \$3,400; due from Marion Cotter \$375. He owed \$525, on account, to Walter Eckert.
2. Bought furniture and fixtures from Ernest Kesler for \$1,100. Gave his 30-day note in payment.
3. Sold merchandise that cost \$875 to Wilbur Radigan, on account, for \$1,300.
4. Paid \$30 cash for insurance on stock.
5. Received check in full from Marion Cotter \$375 (item 1).
6. Bought a cash register for \$75, on account, from the National Cash Register Company.
7. Paid miscellaneous expense of \$275.
8. Drew for own use \$150.
9. Paid Walter Eckert's account in full \$525 (item 1).
10. Wilbur Radigan returned merchandise of \$350. Cost of this merchandise was \$200.
11. Sold merchandise that cost \$1,000 for \$1,750 cash.
12. The following assets were consumed in conducting the business: \$2.50 of the insurance (item 4); all of the miscellaneous expense \$275 (item 7).

CHAPTER X

EXPANSION BY SUBSTITUTION (Continued)

Purpose of Chapter.—

1. Expansion of Merchandise into Inventory, Purchases, and Sales.
2. Finding the cost of goods sold.
3. Determining profit.
4. Expansion of Expense title.
5. Profit and loss and capital.

Expanding the Merchandise Title.—While the title, Merchandise, permits showing increases and decreases in this asset, it fails to provide all the information usually desired concerning it. Accordingly, we substitute the three titles, Merchandise Inventory or Stock, Merchandise Purchases, and Merchandise Sales, as being more convenient devices for gathering information. Merchandise Inventory represents the stock of merchandise on hand at the beginning of the period; Merchandise Purchases, the goods acquired during the period; and Merchandise Sales, the goods sold during the period. The selling price is really composed of two parts, one representing the decrease in the asset, Merchandise, the other the gross profit on the sale, i.e., the increase of capital.

The following transactions will show this:

1. Frank Munson began business with \$2,000 in merchandise.
2. Sold merchandise that cost \$1,000 for \$1,400 in cash.
3. Bought merchandise for cash \$1,200.
4. Sold merchandise that cost \$200 to A. C. Knox for \$300 on account.
5. Bought \$500 merchandise from Ryan and Company on account.

6. Munson returned to Ryan and Company the \$500 merchandise bought from them (item 5), because it was of inferior grade.
7. A. C. Knox returned all the merchandise sold him (item 4), because it was not what he ordered.

With the account titles formerly used, the above information in the expanded equation would appear as follows:

CASH			
<i>Increases</i>		<i>Decreases</i>	
(2).....	\$1,400	(3).....	\$1,200
MERCHANDISE			
<i>Increases</i>		<i>Decreases</i>	
(1) Inventory.....	\$2,000	(2) Cost of goods sold....	\$1,000
(3) Purchases.....	1,200	(4) Cost of goods sold...	200
(5) Purchases.....	500	(6) Returned Purchases	
(7) Returned Sale (item 4)	200	(item 5).....	500
	3,900		1,700
ACCOUNTS RECEIVABLE			
<i>Increases</i>		<i>Decreases</i>	
(4) A. C. Knox.....	\$300	(7) Returned by A. C. Knox (item 4).....	\$300
ACCOUNTS PAYABLE			
<i>Decreases</i>		<i>Increases</i>	
(6) Returned to Ryan and Company (item 5)...	\$500	(5) Ryan and Company..	\$500
FRANK MUNSON'S CAPITAL			
<i>Decreases</i>		<i>Increases</i>	
(7) (Item 4).....	\$100	(1).....	\$2,000
		(2) Profit.....	400
		(4) Profit.....	100

The handling of the first five items has already been explained in Chapter IX. Number 6 has the effect of reversing item 5.

The return of the goods decreases the asset, Merchandise, by canceling the increase of \$500 (item 5), and since Munson no longer owes Ryan and Company it also decreases the liability, Accounts Payable, \$500, as recorded on the left of Accounts Payable (item 6). Number 7 reverses transaction 4. Number 4 recorded an increase of \$300 in the asset, Accounts Receivable; a decrease of \$200 in the asset, Merchandise, and an increase in Munson's Capital of \$100. When Knox returned the merchandise just the opposite effect was produced, therefore number 7 appears as a decrease in the asset, Accounts Receivable, of \$300; an increase in the asset, Merchandise, of \$200, and a decrease in Munson's Capital of \$100.

You have no doubt observed that the Merchandise title contains three items of information, viz., Inventory, or Stock, of Merchandise at the beginning of the period, Purchases, or increases during the period, and Sales, or decreases during the period. These last two are subject to corrections because goods are returned by or to us, and therefore the total Purchases and Sales are not easily obtained.

Since the three titles provide a more convenient device than the single one, let us expand Merchandise into Merchandise Inventory, Merchandise Purchases, and Merchandise Sales. The three, however, as a group still represent Merchandise.

The Merchandise title is shown on page 108 in its original form. The three titles which have been substituted for it are given below:

MERCHANDISE INVENTORY

<i>Increases in assets</i>		<i>Decreases in assets</i>
(1)..... \$2,000		

MERCHANDISE PURCHASES

<i>Increases in assets</i>		<i>Decreases in assets</i>
(3)..... \$1,200		(6) Returned to Ryan
(5)..... 500		and Company (item
		5)..... \$500

MERCHANDISE SALES

<i>Increases in assets</i>		<i>Decreases in assets</i>	
(7) Returned by A. C.		(2) Cost of goods sold....	\$1,000
Knox (item 4).....	\$200	(4) Cost of goods sold....	200

Summarizing the Equation.—Combining the information found under the titles, Cash and Frank Munson's Capital, with the three Merchandise titles above, we have the following:

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

Date ———

Assets:	
Cash (excess of increases over decreases)	\$ 200 -
Merchandise (excess of increases over decreases)	2,200 -
(Inventory, \$2,000 + net Purchases, \$1,200 = \$3,200)	
(\$3,200 - net Sales at cost, \$1,000 = \$2,200)	
Total.....	\$2,400 -
Liabilities:	
None.....	0
Capital (excess of increases over decreases)	\$2,400 -

This capital is verified by deducting liabilities from assets.

FRANK MUNSON

STATEMENT SHOWING SOURCES OF INCREASES AND DECREASES IN CAPITAL

from ——— to ——— 19—

Increases:	
Profit on sale of merchandise (item 2)	\$400 -
Profit on sale of merchandise (item 4)	100 -
Total.....	\$500 -
Decreases:	
Profit on sale of merchandise returned (item 7)	
when accounts receivable was decreased \$300	
and merchandise was increased \$200.....	100 -
Net Increase in Capital.....	\$400 -

EXPLANATION OF FRANK MUNSON'S CAPITAL

Date—

Investment at beginning.....	\$2,000 -
Add Net Increase in Capital	400 -
Capital at the end	<u>\$2,400 -</u>

Finding Profits in Totals.—In most businesses it is not convenient and does not add to our information to find the profit (increase in capital) at the time of sale on each article sold. The information desired is the total profit on sales for a month or year. Again, the cost of determining the profit on each sale would more than absorb or offset the profit, making this plan impracticable. For example, a retail merchant selling thread by the spool at, say, 6 cents per spool with a cost of 5 $\frac{9}{10}$ cents per spool would produce a profit of $\frac{1}{10}$ cent. In recording this, we indicate correctly the effect of the transaction on assets and capital, as follows:

	CASH	
<i>Increase in assets</i>		
..... 6¢		
	MERCHANDISE SALES	
		<i>Decrease in assets</i>
		 5 $\frac{9}{10}$ ¢
	CAPITAL	
		<i>Increase in capital</i>
		 $\frac{1}{10}$ ¢

But the time consumed and the inconvenience of using fractions of a cent more than obviate the benefits of correct recording.

Since decrease in assets and increase in capital are both

entered on the right side of the equation, we may record both under the title, Merchandise Sales, as a single item, thus:

	CASH	
<i>Increase in assets</i>		
..... \$.06		
	MERCHANDISE SALES	
		<i>Decrease in assets</i>
		<i>and</i>
		<i>Increase in capital</i>
		 \$.06

If 10,000 articles were sold, the conditions might be stated thus:

	CASH	
<i>Increase in assets</i>		
..... \$600		
	MERCHANDISE SALES	
		This represents:
		{ <i>Decrease in assets</i> \$590
		<i>and</i>
		{ <i>Increase in capital</i> 10
		\$600

In many retail concerns the salesmen do not know the cost price of the articles they sell, thus making it more convenient to use the selling price instead of the cost price in recording sales.

Removing the Profit.—If the amount of profit on all the sales is known, it may be transferred to capital as follows:

	MERCHANDISE SALES	
To Capital..... \$10		 \$600
	CAPITAL	
		From Sales..... \$10

By entering the item of \$10 Profit on the left side of Merchandise Sales we leave the difference \$590 as the cost of the goods sold (decrease in assets) on the right side, and by entering \$10 on the right of Capital we indicate the increase in capital from the profit on all sales. Another plan is to enter on the left side of Merchandise Sales the *cost of the goods sold*, leaving on the right side the profit (difference between sales of \$600 and cost of \$590), which may then be transferred to Capital in the usual manner.

MERCHANDISE SALES			
Cost of goods sold.....	\$590	(Cost 590, Profit 10).....	\$600
Profit.....	10		
CAPITAL			
		Profit on Sales.....	\$10

We shall now carry out a series of transactions to show the source of the profit and how it is transferred to capital.

1. John Smith began business with \$1,000 in cash.
2. Bought merchandise for cash \$1,000.
3. Sold all the merchandise for \$1,200 in cash.

Trace these by number to the following equation:

CASH			
<i>Increases</i>		<i>Decreases</i>	
(1).....	\$1,000	(2).....	\$1,000
(3).....	1,200		
MERCHANDISE PURCHASES			
<i>Increases</i>			
(2).....	\$1,000		
MERCHANDISE SALES			
		<i>Decrease in assets and Increase in capital</i>	
		(3).....	\$1,200

JOHN SMITH'S CAPITAL

			<i>Increases</i>
	(1).....		\$1,000

The equation below shows the same information and in addition shows transactions 4 and 5 which transfer the profit to capital.

CASH			
(1).....	\$1,000	(2).....	\$1,000
(3).....	1,200		
MERCHANDISE PURCHASES			
(2).....	\$1,000	(4) Transfer to Sales	
		(cost of goods sold)	\$1,000
MERCHANDISE SALES			
(4) From Purchases.....	\$1,000	(3).....	\$1,200
(5) Profit transferred to Capital.....	200		
JOHN SMITH'S CAPITAL			
		(1).....	\$1,000
		(5) Profit from Sales.....	200

Transaction 4 indicates the transfer of the *cost of goods sold* from Merchandise Purchases to Merchandise Sales, and transaction 5 transfers the *increase in capital* from Merchandise Sales to John Smith's Capital.

Combining Titles and Determining Profits.—For convenience in finding profit the information collected during the period under the above titles is transferred at the end of the period to the title, Trading in Merchandise, or simply, Trading.

Let us illustrate this by the following transactions.

1. Charles Welsh began business with \$3,000 in merchandise.
2. Sold merchandise for cash \$2,500.
3. Bought merchandise for cash \$1,500.

After recording these transactions the equation appears:

CASH	
(2).....	\$2,500
(3).....	\$1,500
MERCHANDISE INVENTORY	
(1).....	\$3,000
MERCHANDISE PURCHASES	
(3).....	\$1,500
MERCHANDISE SALES	
(2).....	\$2,500
CHARLES WELSH'S CAPITAL	
(1).....	\$3,000

To determine the amount of profit we transfer the differences in each merchandise title to the title, Trading in Merchandise. The separate steps needed to make the transfer are listed by number below.

4. The transfer of Merchandise Inventory to Trading in Merchandise, \$3,000.
5. The transfer of Merchandise Purchases to Trading in Merchandise, \$1,500.

Steps 4 and 5 are taken for the purpose of finding the *total amount of the goods available for sale*. This amount, \$4,500, is composed of the original inventory of \$3,000 and the purchase of \$1,500, these items now being brought together on the left side of the title, Trading in Merchandise.

6. The transfer of the amount of goods remaining on hand unsold, \$2,500, from Trading in Merchandise to Merchandise Inventory.

The effect of this transfer is to separate into two parts the \$4,500 of goods available for sale. One of these parts represents the unsold portion, \$2,500, just referred to, which now appears on the left side of Merchandise Inventory. The other, \$2,000, represents the cost of goods sold and is now indicated by the excess of

the left side of Trading in Merchandise, \$4,500, over the right side, \$2,500 ($\$4,500 - \$2,500 = \$2,000$).

7. The transfer of Merchandise Sales to Trading \$2,500.

8. The transfer of *profit* (increase in capital) to Capital \$500.

After the above transfers have been made the equation appears as follows:

CASH	
(2).....	\$2,500
(3).....	\$1,500
MERCHANDISE INVENTORY	
(1).....	\$3,000
(6) Transferred from Trading.....	\$2,500
(4) Transferred to Trading.....	\$3,000
MERCHANDISE PURCHASES	
(3).....	\$1,500
(5) Transferred to Trading.....	\$1,500
MERCHANDISE SALES	
(7) Transferred to Trading.....	\$2,500
(2).....	\$2,500
TRADING IN MERCHANDISE	
(4) Merchandise Inventory.....	\$3,000
(5) Merchandise Purchases.....	1,500
	\$4,500
Difference (cost of goods sold).....	\$2,000
(8) Profit transferred to Capital.....	500
	\$2,500
(6) Inventory at end... Difference equals cost of goods sold.	\$2,500 2,000*
(7) Sales.....	\$2,500
	\$4,500
	\$2,500

* To show this excess as a separate item, the amount \$2,000 is entered on the right of Trading in Merchandise and brought down on the left below the \$4,500 total.
This device or method of balancing is used when it is desired to show as a separate item

CHARLES WELSH'S CAPITAL

(1)	\$3,000
(8) Profit transferred from Trading.....	500

The information now contained in the equation may be summarized as follows:

CHARLES WELSH

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

Date—

Assets:	
Cash	\$1,000 —
Merchandise	2,500 —
Total	\$3,500 —
Liabilities:	
None	0 —
Capital	\$3,500 —

Finding the Cost of Goods Sold.—Out of the difficulty and impracticability of keeping record of the cost of each article sold has come the method of recording at sales prices all sales as they are made. As shown in the equation on page 114 this makes necessary the transfer at some time of the profit from the Sales title to the Capital title. This is not done as each sale is recorded, but only at the end of the business year or other period when the merchant desires to sum up his business for the year and determine his condition. Before he can do this he must find the cost

the difference between the two sides of a record. The side on which the lesser amount appears is made equal to the other side by entry in it of the difference between them. The two sides are now said to balance and are totaled and ruled off. The amount of the excess, entered on the lesser side to make the two sides "balance," is now set up below the totals on the side which was originally the larger. The student will appreciate that no real change has been made in the record, for equal amounts—\$2,000 in this case—have been added to both sides. Then from each side of the record equal amounts—\$4,500 in the above example—have been ruled off or out of the record. This leaves in it just the one distinct and separate item, the amount of excess of one side of the original record over the other.

of the goods he has sold. While no record has been kept of the cost of each article sold, the merchant does keep a record of the amount of goods he has available for sale. This is composed of the goods on hand at the beginning and the goods he has bought since. He must account for all of these. Some he has sold; the rest he should have on hand unsold. Using the terms "Initial Inventory" and "Final Inventory" for these items, we may express this accounting in the form of the equation which follows:

$$\text{Initial Inventory} + \text{Purchases} = \text{Final Inventory} + \text{Cost of Goods Sold}$$

The left side of this equation is known, since a record has been kept of both items. Neither of the right-hand members is known. The merchant must therefore find the amount of either one of these. The difficulties in finding the Cost of Goods Sold have already been referred to. It is not difficult, however, once a year—or oftener—to find the amount of the Final Inventory by making an actual count of the merchandise unsold in the store, as explained in Chapter V. With this information it is now possible to determine the Cost of Goods Sold, the remaining unknown quantity in the above equation, sometimes called the "Cost of Goods Sold equation."

This information when expressed in statement form will appear as follows, using the figures of the Charles Welsh problem:

1. Inventory at beginning.....	\$3,000 -
2. Plus Purchases.....	1,500 -
3. Equals total cost of merchandise available for sale...	\$4,500 -
4. Less Inventory at end of period.....	2,500 -
5. Leaves cost of goods sold.....	<u>\$2,000 -</u>

Finding the Profit.—After the determination of the cost of goods sold (amount of decrease in the asset, merchandise) it is a

simple matter to find the amount of profit. Either of the two forms below may be used for this purpose. The first shows the information in statement form; the second in the form of the vertical equation.

STATEMENT FORM

1. Sales (Decrease in Assets + Increase in Capital).....	\$2,500 -
2. Less Cost of Goods Sold (Decrease in Assets).....	2,000 -
3. Leaves Profit (Increase in Capital).....	<u>\$ 500 -</u>

VERTICAL EQUATION FORM

Cost of Goods Sold.....	\$2,000	Merchandise Sales.....	\$2,500
Profit.....	500		
	<u>\$2,500</u>		<u>\$2,500</u>

Referring again to the expanded equation on page 116, note that it contains all the information which has just been shown in the statement of assets, liabilities, and capital, in the statement showing the cost of goods sold, and in that showing the profit. After transferring this period's information from Merchandise Inventory (initial inventory), Merchandise Purchases, and Merchandise Sales, these titles can be used for recording merchandising information during the next period. The records for the two periods will thus be separate and distinct, the double horizontal lines clearly dividing them.

Expanding the Expense Title.—Under the general title, Expense, have up to this time been recorded the increases and decreases of all expense purchases consumed quickly in operating the business. This is not usually sufficiently definite, because it does not furnish detailed information in regard to in-

creases and decreases in the different kinds of expense purchases making up this group.

We shall now substitute for the general title, Expense, the names of the different kinds of items composing it. There may be any number of names for the different items, but a study of some typical ones, such as Rent, Salaries, Stationery and Printing, Insurance, and Postage Stamps, will be sufficient to show how the substitution is accomplished. In the illustration below, the various items are first recorded under the title, Expense, and then the same information is shown in more expanded form by substituting the several separate titles.

EXPENSE		
<i>Increases</i>		<i>Decreases</i>
Rent.....	\$ 300	
Salaries.....	1,500	
Stationery and Printing..	50	
Insurance.....	60	
Postage Stamps.....	20	
Miscellaneous.....	200	

Substituting for the general title, Expense, the names of the different kinds of items which compose it, we have the following:

RENT		
<i>Increases</i>		<i>Decreases</i>
.....	\$300	

SALARIES		
<i>Increases</i>		<i>Decreases</i>
.....	\$1,500	

STATIONERY AND PRINTING		
<i>Increases</i>		<i>Decreases</i>
.....	\$50	

INSURANCE		
<i>Increases</i>		<i>Decreases</i>
.....	\$60	
POSTAGE STAMPS		
<i>Increases</i>		<i>Decreases</i>
.....	\$20	
MISCELLANEOUS EXPENSE		
<i>Increases</i>		<i>Decreases</i>
.....	\$200	

Usually only the more important items are given separate titles and the general term, Expense, is retained for miscellaneous items, such as carfares, papers, telephone and telegrams, small donations to charity, etc.

The manner of handling these detailed expense records is exactly the same as that of the regular asset records. Entries on the left indicate increases, and those on the right decreases. The right-hand entries indicate the portions of the expense purchases consumed in operating the business and are, therefore, decreases in capital. As explained in Chapter VI, page 62, however, these are treated as deductions from Gross Profit before being transferred to the Capital record where only the net amount representing the net increase or decrease in capital resulting from the period's operations will appear. If all of an expense purchase is not used up in one period, the part remaining is an inventory or balance, to be shown as still on hand for the next period. At the end of the current period this balance is a true expense asset, representing unused expense purchases. An illustration will bring out these points more clearly.

Referring to the example above, assume that \$200 of the Rent (right to use the building) has been consumed. The method of transferring the part consumed is shown in the Rent record as follows:

RENT

<i>Increases</i>		<i>Decreases</i>	
.....	\$300	Transferred to Capital.....	\$200
		(Representing part of purchase consumed)	
		Balance.....	100
		(Representing inventory or part held over for consumption next year)	
	<u>\$300</u>		<u>\$300</u>
Balance (inventory).....	\$100		

If all of the expense purchase has been consumed, this is shown as indicated below in the Salaries record.

SALARIES

<i>Increases</i>		<i>Decreases</i>	
.....	<u>\$1,500</u>	Transferred to Capital...	<u>\$1,500</u>
		(Representing expense purchases consumed in operating the busi- ness)	

Summarizing Increases and Decreases in Capital.—In the above illustrations the portions of the expense purchases consumed are shown transferred to Capital. Instead of transferring them direct to Capital it is customary to summarize them under another title, Profit and Loss, to which is also transferred the gross profit on sales. This summary title represents a *net increase* or *net decrease* in capital (Net Profit or Net Loss) which is transferred to the Capital title as a single item.

The following illustration shows the manner of handling the Profit and Loss title. The left-hand items represent expense

purchases consumed and transferred from their individual titles. The right-hand item represents gross profit transferred from Trading in Merchandise. Profit and Loss is a *temporary* capital title used solely for the purpose of summarizing these capital changes before the more permanent record is made in the Capital title. The balance, i.e., the difference between the two sides, is always transferred to Capital.

PROFIT AND LOSS

<i>Decreases in Capital</i>		<i>Increases in Capital</i>	
Transferred from Rent...	\$ 200	Transferred from Trading	\$3,000
" " Salaries	1,500		
" " Station- ery and Printing.....	40		
Transferred from Insur- ance.....	50		
Transferred from Postage Stamps.....	10		
Transferred from Miscel- laneous Expense.....	200		
Total.....	\$2,000		
Net Profit transferred to Capital.....	1,000		
	\$3,000		
			\$3,000

CAPITAL

*Decreases**Increases*

Original.....	\$5,000
Net Profit transferred from Profit and Loss...	1,000

It is obvious that the net effect on capital of the operations during the period is more clearly indicated by the use of the Profit and Loss title than by transferring each change to Capital individually.

It now remains to apply in a series of transactions all the new principles explained in this chapter. A series of business transactions is recorded under appropriate titles. The result of the transactions is then summarized and transferred to Capital. The student should trace carefully each one of the transactions by number to the titles affected in the equation.

1. William Winton began business with \$7,000 in cash and \$3,000 in merchandise.
2. Bought merchandise from E. Z. Dunn, on account, \$5,000.
3. Bought store and office furniture and fixtures for cash \$1,500.
4. Paid cash \$50 for stationery and other printed matter for use in office and store.
5. Paid \$200 in cash in advance for one month's rent.
6. Sold merchandise for cash \$2,200.
7. Returned merchandise to E. Z. Dunn (see item 2) as not being up to grade, \$100.
8. Sold merchandise to Henry Bates, on account, \$4,000.
9. Paid clerks' salaries in cash \$150.
10. Henry Bates returned \$200 of the merchandise sold to him (see item 8) because it was not what he ordered.

The following numbers have reference to the summarizing transactions.

11. Initial Inventory of Merchandise transferred to Trading \$3,000.
12. The balance of Merchandise Purchases transferred to Trading \$4,900.
13. The present inventory of merchandise is found to be \$3,500. This was obtained by listing all unsold merchandise and valuing it at cost or market price, whichever was lower. Transferred to Merchandise Inventory.
14. Balance of Trading which represents the cost of the merchandise sold is \$4,400. This results from merely deducting item 13, cost of merchandise unsold (inventory) from the left side, the total of which, \$7,900, consists of cost of merchandise sold and cost of merchandise unsold.
15. The balance of Merchandise Sales transferred to Trading \$6,000.
16. The Gross Profit (gross increase in capital) transferred to the Profit and Loss summary title \$1,600.
17. It is estimated that \$40 of the Stationery and Printing has been consumed in conducting business. This was obtained by listing or estimating all the unconsumed material at cost, making the present Inven-

tory \$10. Since there is no element of profit to be considered, the simplest way to treat this title is to remove the amount of this item which has been consumed, \$40.

18. The balance of the Stationery and Printing title stated in a single amount is \$10 and is called an Inventory. It is an expense asset.

19. Since all the expense purchase represented by the title, Rent (right to use the building), has been consumed, the whole amount, \$200, is transferred to Profit and Loss.

20. All of the item, Salaries (services of the clerks and other employees), has been consumed. Therefore the total in this title, \$150, represents a decrease in capital and is transferred to Profit and Loss.

21. The balance of Profit and Loss representing the excess of increases over decreases in capital (Net Profit) is transferred from Profit and Loss to Winton's Capital \$1,210.

CASH

(1).....	\$7 000	(3).....	\$1,500
(6).....	2,200	(4).....	50
		(5).....	200
		(9).....	150

MERCHANDISE INVENTORY

(1).....	\$3,000	(11) Trading.....	\$3,000
(13) Trading.....	\$3,500		

MERCHANDISE PURCHASES

(2).....	\$5,000	(7).....	\$ 100
		(12) Trading.....	4,900
	<u>\$5,000</u>		<u>\$5,000</u>

MERCHANDISE SALES

(10).....	\$ 200	(6).....	\$2,200
(15) Trading.....	6,000	(8).....	4,000
	<u>\$6,200</u>		<u>\$6,200</u>

FURNITURE AND FIXTURES

(3)..... \$1,500

STATIONERY AND PRINTING

(4)..... \$ 50

(17) Profit and Loss..... \$ 40

(18) Balance, Inventory.. 10

\$ 50\$ 50

(18) Balance, Inventory.. \$ 10

RENT

(5)..... \$200(19) Profit and Loss..... \$ 200

ACCOUNTS RECEIVABLE

(8) Henry Bates..... \$4,000

(10) Henry Bates..... \$200

SALARIES

(9)..... \$ 150(20) Profit and Loss..... \$ 150

ACCOUNTS PAYABLE

(7) E. Z. Dunn..... \$ 100

(2) E. Z. Dunn..... \$5,000

TRADING IN MERCHANDISE

(11) Merchandise Inventory..... \$3,000

(13) Merchandise Inventory (new)..... \$3,500

(12) Merchandise Purchases..... 4,900

(14) Balance equals cost of Merchandise sold..... 4,400

\$7,900\$7,900

(14) Balance equals cost of Merchandise sold..... \$4,400

(15) Merchandise Sales.. \$6,000

(16) Profit and Loss..... 1,600

\$6,000\$6,000

PROFIT AND LOSS

(17) Stationery and Printing.....	\$ 40	(16) Profit on Trading...	\$1,600
(19) Rent.....	200		
(20) Salaries.....	150		
(21) To Capital.....	1,210		
	<u>\$1,600</u>		<u>\$1,600</u>

WILLIAM WINTON'S CAPITAL

(1)	\$10,000
(21) Profit and Loss....	1,210

The Equation in Statement Form.—The information in the equation in regard to the assets, liabilities, and capital of William Winton and the sources of the increases and decreases in his capital may be presented in statements much more compact and easier to read, especially for the man who is not familiar with accounting. Let it be assumed that the transactions took place during the period from March 1 to 31, 19—.

WILLIAM WINTON

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

March 31, 19—

Assets:		
Cash.....	\$ 7,300 —	
Merchandise.....	3,500 —	
Furniture and Fixtures.....	1,500 —	
Stationery and Printing.....	10 —	
Accounts Receivable.....	<u>3,800 —</u>	
Total Assets.....		\$16,110 —
Liabilities:		
Accounts Payable.....	\$ 4,900 —	
Total Liabilities.....		<u>4,900 —</u>
Capital:		
Wm. Winton's Capital (Original).....	\$10,000 —	
Plus Net Increase (Net Profit).....	<u>1,210 —</u>	
Total Capital.....		<u>\$11,210 —</u>

WILLIAM WINTON

STATEMENT OF PROFIT AND LOSS

from March 1 to 31, 19—

Sources of Increases in Capital:	
Sales.....	\$6,000 —
<i>Deduct:</i> Cost of Goods Sold	
Purchases.....	\$5,000 —
<i>Less:</i> Returns.....	100 —
Net Purchases.....	\$4,900 —
<i>Add:</i> Inventory 3/1/—.....	3,000 —
Cost of goods available for sale.....	\$7,900 —
<i>Less:</i> Inventory 3/31/—.....	3,500 —
Cost of Goods Sold.....	4,400 —
Gross Profit on Sales.....	\$1,600 —
Sources of Decreases in Capital:	
Rent consumed.....	\$ 200 —
Salaries consumed.....	150 —
Stationery and Printing consumed.....	40 —
Total.....	390 —
Net Profit (Net Increase in Capital).....	\$1,210 —

Note that the title of this statement has been changed. Profit and Loss is but another name for increases and decreases in capital. This title is more in accord with that used in the vertical equation to show increases and decreases of capital and as its use is general in business, we shall use it in the future.

QUESTIONS

1. What is meant by "expansion by substitution?"
2. What titles are substituted for the title, Merchandise? Illustrate.
3. (a) Discuss the disadvantages of finding the profit on each sale at the time the sale is made. (b) How may the disadvantages be overcome?

4. What is the purpose in setting up the Trading in Merchandise title?
5. Into what two parts may the "total cost of goods available for sale" be divided?
6. Explain how to find the cost of the goods sold in the Trading in Merchandise title.
7. Into what two parts may the selling price be divided?
8. How is the increase in capital transferred from the Trading in Merchandise title to the Profit and Loss title?
9. Show how you would find the cost of goods sold arithmetically.
10. What is the "key" to the solution?
11. At what price should inventories of merchandise be entered when finding the cost of goods sold? Why?
12. Indicate by means of skeleton titles the steps taken to find the gross profit on sales.
13. What is the purpose of substituting several special titles for the general title of Expense?
14. Explain the purpose of the Profit and Loss title.
15. What is meant by "net profit?"
16. (a) What information does a profit and loss statement contain? (b) Where may this information be found in the equation after closing?

PROBLEMS

1. (a) Expand the following Merchandise title by substituting the titles, Merchandise Inventory, Merchandise Purchases, and Merchandise Sales.

MERCHANDISE

(1) Inventory at beginning	\$1,000	(2) Cost of goods sold . . .	\$ 800
(3) Purchases	4,000	(5) Cost of goods sold . . .	3,000
(4) Returned Sale (item 2)	300	(7) Returned Purchase	
(6) Purchases	2,000	(item 6)	200

- (b) Find the present inventory.

2. (a) Record the following transactions in equation form, using Merchandise Purchases and Merchandise Sales titles.
1. William White began business with \$5,000 in cash.
2. Bought merchandise for cash \$4,000.
3. Sold all the merchandise for \$5,000 in cash.

(b) Close the Merchandise Purchases and Merchandise Sales titles and transfer the profit to Capital.

3. (a) Record the following transactions in the expanded equation form. The figures after each title indicate the number of lines to allow. Cash 4, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 3, Trading in Merchandise 7, Walter Elliott, Capital 4.

1. Walter Elliott began business with \$1,000 in merchandise and \$4,000 in cash.
2. Bought merchandise for cash \$3,000.
3. Sold merchandise for cash \$4,800.

(b) Open a Trading in Merchandise title and find the *cost of goods sold*, if the *cost of goods unsold* amounts to \$500.

(c) Find the gross profit on sales and transfer it to Capital.

(d) Prepare, in arithmetical form, a statement showing:

1. The cost of the goods sold.
2. The gross profit on sales.

4. (a) Record in expanded equation form. Allow the following number of lines for each title: Cash 5, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 5, Trading in Merchandise 8, L. E. Strong, Capital 4.

1. L. E. Strong began business with \$2,000 in merchandise and \$5,000 in cash.
2. Bought merchandise for cash \$4,000.
3. Sold merchandise for cash \$5,500.
4. Bought merchandise for cash \$3,000.
5. Sold merchandise for cash \$3,500.

(b) Open a Trading title and find the cost of goods sold if the inventory amounts to \$1,500.

(c) Find the gross profit on sales and transfer it to Capital.

5. (a) Record in expanded equation form. Allow the following number of lines for each title: Cash 5, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 6, Accounts Payable 3, Trading in Merchandise 8, A. C. Bennett, Capital 4.

1. A. C. Bennett began business with \$3,000 in cash and \$7,000 in merchandise.
2. Sold to R. F. Brown, for cash, merchandise \$4,000.
3. Bought from U. S. Kennedy, for cash, merchandise \$3,500.

4. Sold to Nixon and Company, on account, \$5,000 in merchandise.
5. Sold merchandise, for cash, \$1,200.
6. Bought from D. F. Clark, on account, \$2,200 in merchandise.

(b) The inventory is \$5,400. Use a Trading title in finding the gross profit on sales and then transfer the profit to Capital.

(c) Prepare a statement of assets, liabilities, and capital.

6. (a) Record in expanded equation form. The figures after each title indicate the number of lines to allow: Cash 4, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 5, Accounts Receivable 5, Accounts Payable 3, Trading in Merchandise 8, John Drew, Capital 4.

1. John Drew began business with \$4,000 in cash; \$5,000 in merchandise, and \$300 due on account from K. V. French.
2. Sold merchandise to Charles Howard, on account, \$4,500.
3. Received \$300 in cash from K. V. French. (See item 1.)
4. Bought merchandise from James and Company, on account, \$3,000.
5. Sold merchandise to Kenny and Company, on account, \$2,700.
6. Paid James and Company cash, on account, \$2,000. (See item 4.)
7. Bought merchandise from H. H. Wright for cash \$1,500.

(b) The inventory is \$4,400. Transfer profits through Trading to Capital.

7. (a) Expand the following Expense title by substituting individual titles. Allow 8 lines for Profit and Loss and 3 lines for each of the other titles.

EXPENSE

<i>Increases</i>		<i>Decreases</i>	
Rent.....	\$500		
Insurance.....	100		
Wages.....	600		
Postage.....	40		
Stationery and Printing....	150		
Miscellaneous Expense....	100		

(b) Assume that \$300 of Rent, and \$100 of Stationery and Printing, and \$75 of Miscellaneous Expense has been consumed, and that all the other assets have been consumed. Transfer the amount of the assets consumed to Profit and Loss.

8. The Profit and Loss title contains the following: Rent \$150; Salaries \$1,200; Insurance \$70; Stationery and Printing \$100; Stable Expense \$300; Miscellaneous Expense \$200; Gross Profit from Trading \$2,900. Show the items entered in a Profit and Loss title and transfer the net profit to Capital.

9. Record in expanded equation form. The figure after each title indicates the number of lines to allow: Cash 6, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 6, Accounts Receivable 4, Rent 6, Salaries 5, Stationery and Printing 6, Accounts Payable 3, Trading in Merchandise 8, Profit and Loss 7, Charles G. Price, Capital 4.

1. Charles G. Price began business with \$4,000 in cash; and \$6,000 in merchandise.
2. Paid Jones and Company cash, for rent, \$500.
3. Sold merchandise \$1,500 to H. S. Daly on account.
4. Paid clerks' salaries in cash \$125.
5. Bought merchandise from R. J. Judson, on account, \$2,200.
6. Paid Standard Printing Company in cash for supplies of stationery and advertising matter \$225.
7. Sold merchandise to O. Henry for cash \$3,000.
8. Paid clerks' salaries in cash \$125.
9. Received cash from H. S. Daly \$1,500. (See item 3.)
10. Sold merchandise to C. J. Deming, on account, \$1,700.

(b) The inventory of merchandise (amount on hand) is \$4,100. The inventories of the various expenses are as follows: rent \$260; stationery and printing \$175; all other expense assets were consumed. Transfer increases and decreases in capital through the Trading title and Profit and Loss title to Capital.

10. (a) Record in expanded equation form. Allow the following number of lines for each title: Cash 9, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 6, Furniture and Fixtures 6, Accounts Receivable 5, Salaries 5, Expense 6, Rent 3, Postage 3, Accounts Payable 5, Trading in Merchandise 8, Profit and Loss 9, David Roswell, Capital 4.

1. David Roswell began business with the following assets and liabilities: cash \$3,500; merchandise \$6,500; furniture and fixtures \$1,000; claims on account against James Baker \$400, and B. A. Butler \$700. He owed, on account, to Decker and Company \$1,000, and L. E. White \$500.
2. Paid Parker and Hill cash for rent \$350.
3. Bought merchandise on account from L. E. White \$2,500.

4. Sold merchandise to A. C. Watson for cash \$3,300.
5. Paid clerks' salaries in cash \$300.
6. Paid cash for miscellaneous expense items \$350. The word "miscellaneous" may be omitted from the title, if you so desire, using only "expense."
7. Sold merchandise to James Baker, on account, \$2,700.
8. Paid cash to L. E. White for amount owed to him at the beginning \$500. (See item 1.)
9. Sold merchandise to B. A. Butler for cash \$3,100.
10. Paid cash for clerks' salaries \$325.
11. Paid cash for postage \$20.
12. Received cash from B. A. Butler for the amount he owed at the beginning \$700. (See item 1.)
13. Bought merchandise for cash from John Hopper \$1,400.

(b) Transfer the increases and decreases in capital through Trading title and Profit and Loss title. You find that all the expense assets except \$150 in miscellaneous expenses have been consumed, that \$100 of the furniture and fixtures has been consumed in operating the business, and that merchandise inventory is \$3,400.

11. (a) Record in expanded equation form. Allow the following number of lines for each title: Cash 6, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 6, Furniture and Fixtures 6, Accounts Receivable 3, Notes Receivable 3, Delivery Equipment 6, Rent 3, Salaries 3, Office Supplies 6, Accounts Payable 4, Trading in Merchandise 8, Profit and Loss 10, Leonard Rush, Capital 4.

1. Leonard Rush began business with \$5,000 in cash; \$7,000 in merchandise; \$1,000 in furniture and fixtures.
2. Sold merchandise to George W. Mason, on account, \$2,000.
3. Bought a delivery car, on account, from Overland Motor Company \$875.
4. Paid Close Realty Company cash for rent \$275.
5. George W. Mason returned \$250 of merchandise (item 2).
6. Bought merchandise, on account, from Gloveteel and Company \$750.
7. Sold merchandise for \$3,200 cash.
8. Paid cash for clerks' salaries \$400.
9. Bought office supplies for \$375 cash.
10. Sold merchandise of \$1,200 to Robert L. Devison, taking his 30-day note in payment.
11. Returned merchandise of \$225 to Gloveteel and Company as unsatisfactory.

(b) Transfer the increases and decreases in capital through Trading title and Profit and Loss title into Capital. Merchandise inventory at close of period is \$2,800. Assets consumed are: clerks' salaries \$400; office supplies \$125; rent \$275; \$15 of delivery equipment; \$10 of furniture and fixtures.

12. (a) Record in expanded equation form. Allow the following number of lines for each title: Cash 7, Merchandise Inventory 6, Merchandise Purchases 3, Merchandise Sales 6, Buildings 3, Furniture and Fixtures 6, Accounts Receivable 5, Insurance 6, Salaries 3, Accounts Payable 3, Notes Payable 3, Trading in Merchandise 8, Profit and Loss 9, Mason Dixon, Capital 4.

1. Mason Dixon began business January 1, 19—, with \$5,000 cash; \$8,800 merchandise; \$25,000 buildings; \$1,200 furniture and fixtures.
2. Sold on account to Eugene Logan \$2,000.
3. Paid for insurance on building \$300 cash.
4. Sold merchandise for \$1,500 cash.
5. Received check for \$1,200 on account, from Eugene Logan (item 2).
6. Drew for personal use \$200 cash.
7. Paid cash for clerks' salaries \$800.
8. Bought merchandise on account from Hervey, Bloom and Company \$2,000.
9. Eugene Logan returned merchandise of \$350 as unsatisfactory.
10. Merchandise valued at \$75 was stolen from store.
11. Gave Hervey, Bloom and Company a note for \$1,000 and paid remainder of account in cash (item 8).
12. Sold merchandise to J. T. Bergin on account \$850.
13. Paid \$55 cash for a new office desk.
14. Eugene Logan paid the balance of his account, \$450 in cash (items 2, 5, and 9).

(b) Transfer the increases and decreases in capital through Trading title and Profit and Loss title to Capital. The following assets were consumed in conducting the business: all of clerks' salaries \$800 (item 7); \$25 of insurance (item 3); and \$12 of furniture and fixtures (item 1). Merchandise inventory is \$7,900.

13. (a) Record in expanded equation form. Four pages of paper are required. The figure after each title represents the number of lines to allow: Cash 9, Merchandise Inventory 6, Merchandise Purchases 9, Merchandise Sales 11, Furniture and Fixtures 9, Accounts Receivable 8, Notes Receivable 4, Donations 3, Salaries 4, Stationery and Printing 7, Freight and Drayage Inward 3, Rent 4, Expense 3, Accounts Payable

6, Trading in Merchandise 15, Profit and Loss 24, William J. Brumm, Capital 5.

(b) Prepare a statement of assets, liabilities, and capital.

(c) Prepare a statement of profits and losses. Assume a period of one month.

1. William J. Brumm began business June 1, 19—, with \$5,000 cash; \$12,000 merchandise; \$1,300 furniture and fixtures. He owed L. P. Day \$300 on account.
2. Paid rent of \$200 cash.
3. Sold merchandise to Morgan T. Ehlers, on account, for \$3,500.
4. Paid cash for clerks' salaries \$650.
5. Gave \$25 cash to Salvation Army.
6. Bought merchandise, on account, from Lord and Taylor \$2,500.
7. Sold merchandise for cash \$2,875.
8. Paid \$325 cash for stationery and printing.
9. Paid \$18 cash for freight and drayage on merchandise purchased.
10. Morgan T. Ehlers paid \$1,500 of his account in cash and gave a note for \$2,000 (item 3).
11. Sold merchandise to B. M. Terrott, on account, \$2,800.
12. Paid \$125 cash for miscellaneous expense.
13. Paid L. P. Day \$300 cash (item 1).
14. Returned merchandise of \$500 to Lord and Taylor because it was not the quality ordered.

(d) Transfer the increases and decreases in capital through Trading title and Profit and Loss title to Capital. You find that all of the expense items except \$125 of stationery and printing have been consumed in conducting the business and \$10 of furniture and fixtures has been consumed. Merchandise inventory is \$7,300.

14. The following transactions represent a continuation of the business of William J. Brumm in Problem 13.

(a) Record in expanded equation form under titles for Problem 13. Add these additional titles: Miscellaneous Expense 3, Shipping Supplies 6, Insurance 6, Postage 3.

1. Paid rent of \$200 cash.
2. Paid cash for clerks' salaries \$650.
3. Sold merchandise to L. P. Day, on account, \$1,800.
4. Received check for \$1,800, on account, from B. M. Terrott.
5. Paid miscellaneous expenses \$325 cash.
6. Bought merchandise, on account, from Excelsior Sales Company, \$2,250.

7. Paid Lord and Taylor in full \$2,000 cash.
8. Sold merchandise to C. M. Hackman for cash \$3,875.
9. Paid \$48 cash for shipping supplies.
10. Paid \$60 cash to New York Insurance Company for insurance on merchandise.
11. Sold merchandise to B. M. Terrott, on account, \$1,625.
12. Paid \$15 cash for postage.
13. Bought merchandise from Engles and White \$1,300 cash.

(b) Transfer the increases and decreases in capital through Trading title and Profit and Loss title to Capital. All of the expense items have been consumed except the following: \$18 of shipping supplies; \$55 of insurance. \$10 of the furniture and fixtures was consumed. Merchandise inventory is \$5,740.

15. (a) Record in expanded equation form. Three pages of paper are required. Allow the following number of lines for each title: Cash 7, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 6, Real Estate 3, Furniture and Fixtures 6, Accounts Receivable 4, Notes Receivable 3, Delivery Equipment 6, Stationery and Printing 6, Salaries 3, Coal 3, Light and Gas 3, Expense 3, Accounts Payable 7, Trading in Merchandise 8, Profit and Loss 11, Rodney C. Murray, Capital 4.

1. Rodney C. Murray started business with the following assets and liabilities: cash \$10,000; merchandise \$20,000; real estate \$175,000; furniture and fixtures \$2,500; owes to Geo. M. Cohen, on account, \$8,000; due from L. F. Wade on notes receivable \$6,500; owes to F. A. Fitzgerald, on account, \$4,760.
2. Bought from Gimble and Dunn, on account, delivery equipment \$2,400.
3. Sold merchandise, on account, to Dusk and Spoons \$7,250.
4. Bought from J. M. Shoemaker and Sons, on account, stationery and printing \$425.
5. Paid cash for salaries \$2,050.
6. Paid cash for coal \$175.
7. Sold merchandise to D. M. Fairbanks, on account, \$9,700.
8. L. F. Wade paid his note in cash \$6,500 (item 1).
9. Returned merchandise to George M. Cohen as unsatisfactory \$2,500.
10. Paid balance of George M. Cohen's account in cash \$5,500 (items 1 and 9).
11. Paid cash for electric light and gas \$48.
12. Bought merchandise from F. A. Fitzgerald, on account, \$8,460.
13. Dusk and Spoons returned merchandise of \$350 (item 3).

14. Paid cash for miscellaneous expenses \$230

15. Sold merchandise for cash \$12,750.

(b) Transfer the increases and decreases in capital through Trading title and Profit and Loss title to Capital. The following expense assets were consumed in conducting the business: \$125 of furniture and fixtures; \$120 of delivery equipment; \$300 of stationery and printing; salaries \$2,050; coal \$175; light and gas \$48; miscellaneous expense \$230. Merchandise inventory is \$8,509.

(c) Prepare a statement of assets, liabilities, and capital.

(d) Prepare a profit and loss statement. Assume a period of 1 year.

16. (a) Record in expanded equation form. Two pages of paper are required. Allow the following number of lines for each title: Cash 5, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 5, Accounts Receivable 3, Rent 3, Salaries 3, Freight and Drayage Inward 3, Coal 3, Accounts Payable 4, Trading in Merchandise 8, Profit and Loss 7, L. V. Goodman, Capital 4.

1. L. V. Goodman started business June 1, 19—, with cash of \$1,000 and merchandise of \$2,500.

2. Sold merchandise to Kaiser and Speers, on account, \$300.

3. Paid cash to C. N. McCoy for rent \$65.

4. Sold merchandise to Mason Hunt for cash \$685.

5. Bought merchandise, on account, from Stewart Brothers \$515.

6. Paid salaries in cash \$225.

7. Paid cash for freight and drayage \$6 on merchandise purchased.

8. Bought coal from B. W. Vayingher, on account, \$60.

9. Received check for \$300 from Kaiser and Speers (item 2).

(b) Transfer increases and decreases in capital through Trading title and Profit and Loss title to Capital. All expense assets were consumed in conducting the business except the coal, none of which was used. Merchandise inventory at close of period is \$1,900.

(c) Prepare a statement of assets, liabilities, and capital.

(d) Prepare a statement of profits and losses. Assume a period of 3 months.

17. (a) Record in expanded equation form. Three pages of paper are required. Allow the following number of lines for each title: Cash 8, Merchandise Inventory 6, Merchandise Purchases 3, Merchandise Sales 6, Furniture and Fixtures 5, Accounts Receivable 4, Taxes 6, Salaries 3, Office Supplies 6, Miscellaneous Expense 3, Accounts Payable 4, Notes Payable 3, Trading in Merchandise 8, Profit and Loss 9, Barney Gray, Capital 4, Real Estate 3.

1. Barney Gray started business January 1, 19—, with \$2,000 cash; \$3,500 merchandise; \$800 furniture and fixtures; real estate \$7,000.
2. Sold merchandise to Harley Ward, on account, for \$750.
3. Received a present of \$1,000 from his father, which he invested in the business.
4. Paid cash for taxes \$58.
5. Paid cash for clerks' salaries \$275.
6. Sold merchandise to Jordan, Marsh Company for cash \$1,200.
7. Received check from Harley Ward for \$750.
8. A fire destroyed merchandise of \$800 and furniture of \$200. No insurance was carried.
9. Bought merchandise, on account, from Benjamin T. Turner \$1,500.
10. Bought a new desk from Carpenter and Son, on account, \$48.
11. Paid cash for office supplies \$36.
12. Paid cash for miscellaneous expense \$120.
13. Drew \$200 cash for personal use.
14. Paid his account with Benjamin T. Turner (item 9) by giving his 60-day note for \$1,500.
15. Sold merchandise to Carl T. Dobbin, on account, for \$750.
16. Bought a typewriter for \$90 cash.

(b) Transfer increases and decreases in capital through Trading title and Profit and Loss title to Capital. The following expense items were consumed in conducting the business: \$38 of taxes (item 4); all of clerks' salaries \$275 (item 5); one-half of the office supplies \$18 (item 11); all of the miscellaneous expense \$120 (item 12); merchandise inventory is \$2,600.

(c) Prepare a statement of assets, liabilities, and capital.

(d) Prepare a statement of profits and losses. Assume a period of 1 month.

18. (a) Record in expanded equation form. Three pages of paper are required. Allow the following number of lines for each title: Cash 8, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 6, Building 3, Furniture and Fixtures 3, Accounts Receivable 6, Notes Receivable 3, Salaries 3, Expense 3, Bad Debts 3, Delivery Expense 3, Light and Heat 3, Salesmen's Traveling Expenses 3, Office Supplies 6, Accounts Payable 6, Trading in Merchandise 8, Profit and Loss 11, Daniel Duncan, Capital 4.

1. Daniel Duncan started business March 1, 19—, with the following assets and liabilities: cash \$4,200; merchandise \$6,500; building \$35,000; furniture and fixtures \$1,200; he owed George F. Connors, on account, \$700; Perry Brown, on account, \$400; due from J. B.

Jackson, on account, \$565; due from F. X. Bushman on notes receivable \$1,200; due from Bill Davis, on account, \$65.

2. Sold merchandise to J. B. Jackson, on account, \$2,600.
3. Paid Perry Brown \$400 cash (item 1).
4. Returned merchandise of \$300 to George F. Conners (item 1).
5. Paid cash for salaries \$375.
6. Paid cash for miscellaneous expense \$135.
7. Received check from Bill Davis for \$50 (item 1). It is found impossible to collect the remainder of his account \$15. (Bad debts.)
8. Paid cash for delivery expense \$9.
9. Paid cash for light and heat \$30.
10. J. B. Jackson returned merchandise of \$600 on account of a mistake in the order.
11. Sold merchandise for cash \$1,400.
12. Paid cash for salesmen's traveling expenses \$28.
13. Bought office supplies from Gristede Brothers, on account, \$195.
14. Bought merchandise, on account, from Perry Brown \$1,950.
15. Sold merchandise to August Nichols and Company, on account, \$2,450.

(b) Transfer increases and decreases in capital through Trading title and Profit and Loss title to Capital. All expense assets were consumed in conducting the business except \$95 of office supplies. Merchandise inventory is \$5,265.

(c) Prepare a statement of assets, liabilities, and capital.

(d) Prepare a profit and loss statement. Assume a period of 4 months.

19. (a) Record in expanded equation form. Two pages of paper are required. Allow the following number of lines for each title: Cash 7, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 7, Furniture and Fixtures 3, Accounts Receivable 4, Salesmen's Commissions 3, Cartage 3, Salaries 3, Telegrams 3, Ice and Distilled Water 3, Accounts Payable 3, Trading in Merchandise 8, Profit and Loss 10, Louis N. Barry, Capital 4.

1. Louis N. Barry started business January 1, 19—, with cash of \$2,000; merchandise of \$2,800; furniture and fixtures of \$800.
2. Sold merchandise for cash \$600.
3. Paid cash for commissions to salesmen \$25.
4. Paid \$5 cash for postage.
5. Sold merchandise to Procter and Gamble on account \$675.
6. Paid cash for salaries \$325.
7. Sold merchandise to L. D. Kruson and Company, on account, \$1,200.

8. Bought merchandise from the Page Hardware Company, on account, \$2,250.
9. Procter and Gamble returned merchandise of \$75 as being damaged. Paid balance of their account in cash \$600 (item 5).
10. The damaged merchandise in item 9 was destroyed.
11. Paid \$4.50 cash for telegrams during the month.
12. Paid \$9.50 cash for ice and distilled water.

(b) Transfer increases and decreases in capital through Trading title and Profit and Loss title to Capital. All expense assets were consumed in conducting the business. Merchandise inventory \$3,565.

(c) Prepare a statement of assets, liabilities, and capital.

(d) Prepare a statement of profit and loss. Assume a period of 6 weeks.

20. (a) Record in expanded equation form. Four pages of paper are required. Allow the following number of lines for each title: Cash 12, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 7, Furniture and Fixtures 3, Investments 3, Accounts Receivable 7, Advertising 3, Office Supplies 7, Salaries 3, Delivery Expenses 3, Postage 7, Donations 3, Shipping Supplies 3, Insurance 6, Coal 6, Accounts Payable 6, Notes Payable 3, Trading in Merchandise 8, Profit and Loss 14, M. S. Hopkins, Capital 4.

1. M. S. Hopkins started business November 1, 19—, with the following assets and liabilities: cash \$1,675.30; merchandise \$15,683.60; furniture and fixtures \$1,150; bonds purchased for investment \$4,240; customers owing him: George L. Geddes \$52.65; Ned Todman \$136.15; Harold Squibb \$925.20. He owes, on account, Gordon Brothers \$1,170.85; Knight, Freeze and Company \$435.15. He owes Roback and Smith \$825 on a note.
2. Paid Harper Brothers \$30 cash for advertising.
3. Sold merchandise to Smithsonian Book Concern, on account, \$1,150.75.
4. Bought office supplies from Carpenter and Company for \$317 cash.
5. Paid cash for rent \$125.
6. Paid cash for salaries \$718.
7. Sold merchandise to Bison and Clark, on account, \$917.25.
8. Received check for \$52.65 from George L. Geddes (item 1).
9. Ned Todman returned goods amounting to \$136.15 as unsatisfactory (item 1).
10. Paid note of \$825 held by Roback and Smith (item 1).
11. Paid cash for delivery expenses \$14.
12. Sold merchandise to sundry customers for \$2,450 cash.

13. Purchased merchandise of Gordon Brothers \$537.18 cash.
14. Took merchandise of \$145 cost price for personal use.
15. Paid cash for postage \$35.
16. Donated \$15 to United Charities.
17. Bought wrapping paper and twine from Davis Paper Works, on account, \$1,250.
18. Paid cash for insurance \$120.
19. Bought coal from the Three State Coal Corporation, on account, \$118.

(b) Transfer increases and decreases in capital through Trading title and Profit and Loss title to Capital. All expense assets were consumed except the following: office supplies \$110; postage \$8; insurance \$110; coal \$90. Merchandise inventory at end of period \$14,003.78.

(c) Prepare statement of assets, liabilities, and capital at end of period.

(d) Assume 1 month's time and prepare a statement of profit and loss.

CHAPTER XI

FURTHER APPLICATIONS OF EXPANSION BY SUBSTITUTION—THE LEDGER AND THE TRIAL BALANCE

Purpose of Chapter.—

1. Individual accounts receivable and payable.
2. Development of the account by means of the horizontal expansion of the equation.
3. Construction and operation of the ledger.
4. Construction and use of the trial balance.

Expanding Accounts Receivable.—The title, Accounts Receivable, represents our claims against others. To expand this title we substitute the names of the individual customers and show under the names of each the increases and decreases of the asset.

To illustrate this substitution the following transactions have been recorded first under the general title, Accounts Receivable, and then under the names of the individual customers, Henry Brown, John Smith, and George Jones.

1. Sold Henry Brown merchandise on account \$1,000.
2. Sold John Smith merchandise on account \$600.
3. Received \$600 in cash from Smith for item 2.
4. Sold George Jones merchandise on account \$500.
5. Henry Brown returned \$200 in merchandise from item 1.
6. Sold John Smith another bill of merchandise on account amounting to \$400.
7. Henry Brown paid \$500 in cash on item 1.
8. Received \$300 in cash from George Jones in part payment of item 4.

First Method

ACCOUNTS RECEIVABLE

<i>Increases</i>		<i>Decreases</i>	
(1) Henry Brown.....	\$1,000	(3) John Smith.....	\$ 600
(2) John Smith.....	600	(5) Henry Brown.....	200
(4) George Jones.....	500	(7) Henry Brown.....	500
(6) John Smith.....	400	(8) George Jones.....	300
	2,500		1,600

Although this title contains all the information, as to increases and decreases, it is difficult to find the increases and decreases for each customer. By substituting their names, we obtain the desired information.

Second Method

HENRY BROWN

<i>Increases</i>		<i>Decreases</i>	
(1).....	\$1,000	(5).....	\$200
		(7).....	500

JOHN SMITH

<i>Increases</i>		<i>Decreases</i>	
(2).....	\$ 600	(3).....	\$600
(6).....	400		

GEORGE JONES

<i>Increases</i>		<i>Decreases</i>	
(4).....	\$ 500	(8).....	\$300

The sum of the excess of increases over decreases under each man's name (Brown, \$300 + Smith, \$400 + Jones, \$200) equals \$900, the same as the difference between the two sides of the Accounts Receivable title. The second method will be used hereafter, except where it is desirable in illustrations to use the abbreviated form of the first method.

Expanding Accounts Payable.—Accounts Payable is a liability title representing the claims of others against us. To

expand it we need only to substitute the names of the individual creditors. To illustrate, the following transactions appear first under Accounts Payable, and then under the names of the individual creditors.

1. Bought merchandise \$1,200 on account from S. C. Hughes.
2. Bought merchandise \$2,000 on account from Burns and Company.
3. Bought merchandise \$1,500 on account from R. T. Howe.
4. Returned to Burns and Company \$300 in merchandise from item 2, because it was not of the right quality.
5. Paid R. T. Howe cash in full of account for item 3.
6. Paid S. C. Hughes \$700 on account of item 1.
7. Paid Burns and Company \$1,000 in cash on account of item 2.
8. Bought from Burns and Company \$800 in merchandise on account.

First Method

ACCOUNTS PAYABLE

<i>Decreases</i>		<i>Increases</i>	
(4) Burns and Company.	\$ 300	(1) S. C. Hughes.....	\$1,200
(5) R. T. Howe.....	1,500	(2) Burns and Company.	2,000
(6) S. C. Hughes.....	700	(3) R. T. Howe.....	1,500
(7) Burns and Company.	1,000	(8) Burns and Company.	800
	3,500		5,500

Substituting names of individual creditors for the general title:

Second Method

S. C. HUGHES

<i>Decreases</i>		<i>Increases</i>	
(6).....	\$ 700	(1).....	\$1,200

BURNS AND COMPANY

<i>Decreases</i>		<i>Increases</i>	
(4).....	\$ 300	(2).....	\$2,000
(7).....	1,000	(8).....	800

R. T. HOWE

<i>Decreases</i>		<i>Increases</i>	
(5).....	\$1,500	(3).....	\$1,500

The sum of the balances of the individual titles is, of course, the same as the balance of the general title, Accounts Payable. The advantages, as to information, of the second method are apparent. It will be used hereafter.

Expanding the Capital Title.—The original investment by the proprietor is shown as an increase in his capital. This title also contains all permanent increases and decreases in his invested capital. Frequently the proprietor withdraws assets, such as money or merchandise, for personal purposes. These withdrawals decrease assets and also decrease capital and might be entered directly on the left side of Proprietor's Capital. However, as a rule, the proprietor does not intend that such withdrawals shall decrease his original capital. He knows that in all probability his capital has increased as a result of operating the business and he now wishes to use some of his increased assets for personal purposes before finding the exact amount of the net increase in his capital. To indicate that these withdrawals are intended as decreases of the capital increase represented by the net earnings of the business (net profit), a temporary capital title is used. To distinguish the proprietor's temporary capital title from the permanent or invested capital title, the word "Drawing," "Personal," or "Private," follows the proprietor's name in the temporary title thus: "Charles Donovan, Drawing."

During the accounting period all temporary increases in capital, including the net profit, will be entered on the right and the temporary decreases on the left of this title. At the end of the accounting period the net increase or decrease in Drawing will be transferred to Capital as additional investment in the business. If it is the proprietor's intention to withdraw money or other assets to the amount of the credit balance of his Drawing title early in the new accounting period, Drawing may be left open, i.e., the step transferring the excess in Drawing to the Capital title may be omitted.

To illustrate the expansion of the Capital title, the transactions given below are first stated under the general title, Capital, and then separated under both titles, Drawing and Capital.

1. Charles Donovan began business with \$6,000 in cash.
2. He withdrew cash for personal use \$100.
3. He withdrew \$70 in merchandise for personal use.
4. He inherited \$1,500, which he used for business purposes.
5. His net profit for the year is \$2,740.

First Method

CHARLES DONOVAN, CAPITAL

(2) Cash..... \$100	(1) Investment..... \$6,000
(3) Merchandise..... 70	(4) Additional Investment 1,500
	(5) Net Profit..... 2,740

Second Method

The two titles appear as follows:

CHARLES DONOVAN, DRAWING

(2) Cash..... \$ 100	(5) Net Profit..... \$2,740
(3) Merchandise..... 70	
(6) Balance, Transferred to Capital..... 2,570	
\$2,740	\$2,740

CHARLES DONOVAN, CAPITAL

	(1) Investment..... \$6,000
	(4) Additional Investment 1,500
	(6) Balance from Draw- ing..... 2,570

Expanding the Equation Horizontally.—In connection with every transaction there is certain information which is valuable

We still retain the equation but have added columns to the left of the amount on each side of the vertical equality sign. The use made of each column and the order in which they appear is indicated below.

Date	Explanation	Amount	Date	Explanation	Amount
------	-------------	--------	------	-------------	--------

The standard form of ledger account is shown in Form 2 which follows:

TITLE

TITLE									
Date		Explanation	Folio	Amount				Date	Explanation
Year	Month			\$	¢			Year	Month
Day				T	H	T	U		
				en	un	en	ni		
				ds	d	s	t		
				T					
				h					
				an					
				d					
				s					
				an					
				d					
				s					

Form 2. Standard Form of Ledger Account

The heavy triple vertical ruling in the center indicates the equality sign and divides the account into two exactly similar parts.

The explanation column usually contains the name or names of the other accounts affected and such other information as is deemed desirable. The folio column records the page number of some other book if an explanation is made elsewhere. We shall not use the folio column in this chapter. The amount column containing the dollar sign (\$) has unit ruling. Reading to the left from the cents (¢) column the rulings are units, tens, hundreds, thousands, etc. This forces one to write units under

units, tens under tens, etc., reducing the tendency to error in adding columns.

The Account.—The information contained under each title in the equation is usually referred to as an “account” and the name of the title as an “account title,” “account heading,” or “caption.” The **account** may be defined as a record of the increases and the decreases with respect to a particular asset, liability, or capital item. It is always a part of the whole equation.

The Ledger.—Other names for the expanded equation arranged in this form are the “ledger,” “book of final entry,” the “master book,” etc. It contains the increases and decreases in assets, liabilities, and capital and additional information of an historical nature. When the accounts contain only the amount, they are called “skeleton” or “T” accounts, and the entire equation is called a “skeleton ledger.”

Debit and Credit.—The words “debit” and “credit” indicate the left and right sides respectively of the equation or ledger. In recording the transaction, bought merchandise for cash \$100, instead of saying, “enter \$100 on the left of the ledger under Merchandise Purchases,” we say, “debit Merchandise Purchases \$100”; and instead of “enter on the right of the ledger under Cash \$100,” we say, “credit Cash \$100.” The words “debtor” and “creditor” refer to people. **Debtor** means one who owes and **creditor** one who is owed. If John Smith owes us he is our debtor, and if we owe Henry White he is our creditor. The abbreviations for “debtor” and “creditor” are, Dr. and Cr. They are also used for “debit” and “credit.”

Recording Transactions in the Ledger.—To show the operation of the ledger we shall record the following transactions:

Cash

19-			19-			
Mar	1	Rd Duncan Invest	4000 -	Mar	16 L E Howell on afc	700 -
	10	L P Andrews on afc	1500 -		16 Mdwr Purchases	2500 -
	15	Elliworth & Co on afc	1200 -			
		C. F. Andrews				
19-			19-			
Mar	16	Mdwr Sales	1500 -	Mar	10 Cash	1500 -
		Elliworth & Co.				
19-			19-			
Mar	9	Mdwr sales	1200 -	Mar	15 Cash, sale of afc	1200 -
	13	Mdwr Sales	2000 -			
		Merchandise Inventory				
19-						
Mar	1	Rd Duncan Invest	3000 -			
		L E House				
19-			19-			
Mar	16	Cash on afc	700 -	Mar	7 Mdwr Pur	1000 -
					15 Mdwr Pur	900 -
		Robert Duncan Capital				
			19- Cash 4000 Mar 1 Mdwr 3000			7000 -
		Merchandise Purchases				
19-						
Mar	7	L E Howell on afc	1000 -			
	15	L E Howell on afc	900 -			
	16	Cash	2500 -			
		Merchandise Sales				
			19-			
			Mar	16	F Andrews on afc	1500 -
				9	Elliworth & Co on afc	1200 -
				13	Elliworth & Co on afc	2000 -

March, 19—

1. Robert Duncan began business with cash \$4,000 and merchandise \$3,000.
4. Sold merchandise to C. F. Andrews on account \$1,500.
7. Bought from L. E. Howe, on account, merchandise \$1,000.
9. Sold Ellsworth and Company merchandise on account \$1,200.
10. Received check from C. F. Andrews for sale of March 4, \$1,500.
13. Sold Ellsworth and Company merchandise on account \$2,000.
14. Paid L. E. Howe on account of invoice of March 7, \$700
15. Bought merchandise from L. E. Howe on account \$900.
15. Received check from Ellsworth and Company for sale March 9, \$1,200.
16. Bought merchandise for cash \$2,500.

Trace these items to the debit and credit of the accounts in the ledger. The date and explanation will identify each transaction.

The Trial Balance.—In previous chapters we learned that when transactions are entered in the equation correctly, the amounts on each side must be the same, else there could not be an equation, i.e., an equality between the two sides. When many amounts are entered in the ledger in the various accounts it is easy to make errors, particularly by entering an amount on the wrong side of the ledger. We must therefore test the ledger periodically to detect errors of this kind. To determine the equality of the two sides we summarize or condense the ledger by writing the equation (ledger) in a form more convenient for adding the total debit and credit amounts. This form is known as the “trial balance.”

The most convenient way to prepare a trial balance is to add and enter in small pencil figures the total debits and the total credits of each account, and then prepare a list, or schedule, by entering on a sheet of paper the page of the ledger, the name of the account, and to the right, in two columns, the total debits and total credits of each account, using a separate line for each account. Next, find the totals of the Debit and Credit columns, which should be equal—balance. (See Form 3a.)

If the trial balance does not *balance*, some error has been made. The mere fact that the trial balance balances, however, does not prove that the recording has been done correctly, although it is usually considered a good test of correctness. If the \$1,000 entered as a debit in Merchandise Purchases account had been debited to Cash instead, the trial balance would still balance, since no change has been made in the total of the debits, but both Cash and Merchandise Purchases accounts would be incorrect.

Perhaps the student can name some other errors that will not affect the equality of the trial balance.

The Two Forms of the Trial Balance.—There are two forms of the trial balance—that just described, called a “trial balance of totals,” and one more generally used, called a “trial balance of differences.” This latter is found by taking the difference between the two sides of each account, and entering an excess of debits over credits in the Debit column and an excess of credits over debits in the Credit column. Each account will show either a debit or a credit balance. Note carefully in the ledger shown the manner of writing the small pencil footings in each account and the way in which the debit or credit excess in each account is shown. Neatness of work counts for much here.

In the above example, if \$3,200 is deducted from each side of the Cash account the result will be an excess debit of \$3,500. A similar operation in the account of C. F. Andrews leaves no balance—therefore it is omitted from the trial balance—in the Ellsworth and Company account an excess debit of \$2,000, and in the L. E. Howe account an excess credit of \$1,200.

A trial balance of differences must balance, because in each account equal amounts have been subtracted from both sides. Thus the principle of this trial balance rests on the mathematical axiom that equals deducted from equals leaves equals.

The two forms of trial balance for the above example follow:

Robert Duncan Trial Balance, March 16, 19—

L.F.	Title of Account	Dr		Cr	
1	Cash	6700	—	3200	—
1	C. F. Andrews	1500	—	1500	—
1	Ellsworth & Co.	3200	—	1200	—
1	Merchandise Inventory	3000	—		
2	L. E. Howe	700	—	1900	—
2	Robert Duncan, Capital			7000	—
2	Merchandise Purchases	4400	—		
2	Merchandise Sales			4700	—
		19500	—	19500	—

Form 3. (a) Trial Balance of Totals

Robert Duncan Trial Balance, March 16, 19—

L.F.	Title of Account	Dr		Cr	
1	Cash	3500	—		
1	Ellsworth & Co.	2000	—		
1	Merchandise Inventory	3000	—		
2	L. E. Howe			1200	—
2	Robert Duncan, Capital			7000	—
2	Merchandise Purchases	4400	—		
2	Merchandise Sales			4700	—
		12900	—	12900	—

Form 3. (b) Trial Balance of Differences

Uses of the Trial Balance.—The uses of the trial balance are as follows:

1. It proves that the ledger is in equilibrium on a certain date.

* Note that the ledger page appears in the column at the left.

2. It provides information in regard to assets, liabilities, and capital in a more convenient form than the ledger for—
 - (a) The preparation of financial statements.
 - (b) The closing of the ledger.
3. It is useful in indicating errors.
4. It provides a condensed list of the debit and credit balances of the accounts in the ledger as of a certain date. These lists for successive dates should be preserved as a permanent record for comparative purposes.

Continuing the Ledger.—To make clear the method of taking successive trial balances before closing the ledger, we shall record additional transactions of Robert Duncan. Trace these to the accounts in the ledger by means of the dates.

March, 19—

17. Paid cash for two months' rent to April 30, \$400.
18. Bought from the Standard Fixture Company, on account, furniture and fixtures for use in the store, \$1,000. Sold to Foster and Flynn, merchandise on account \$3,000.
20. Paid clerks' salaries in cash \$210.
21. Received from Ellsworth and Company to apply on account, cash \$500 and their 30-day note for \$1,000.
23. Bought invoice of merchandise from Dean and Johnson on account \$1,500.
24. Paid cash for office supplies \$70.
25. Bought invoice of merchandise from F. S. Morse on our 30-day note \$1,600.
26. Proprietor withdrew \$50 in cash for personal use.
28. Paid the Standard Fixture Company by check \$1,000.
29. Sold merchandise to C. F. Andrews on account \$1,400.
30. Returned to Dean and Johnson \$400 in merchandise from invoice of the 23rd because the goods were of inferior quality.
31. Foster and Flynn gave us their 30-day note for \$2,000 to apply on account.

Cash

(Page 1)

19-					19-				
Mar	1	R. B. Duncan, Invoice	430.00	-	Mar	1st	S. E. Flowers, on a/c	7.00	-
	10	R. B. Duncan, on a/c	150.00	-		16	M. J. Par	350.00	-
	15	Ellsworth & Co. on a/c	120.00	-		17	Rent (2 mos)	40.00	-
	21	Ellsworth & Co. on a/c	50.00	-		20	Expense (clerk's sal.)	21.00	-
			720.00	-		24	Expense (office sup.)	7.00	-
						26	R. B. Duncan, Drawing	50.00	-
						28	Standard Fire Co. %	100.00	-
								299.00	-

Notes Receivable

19-									
Mar	21	Ellsworth & Co. (30 days)	100.00	-					
	31	Foster & Flynn (30 days)	200.00	-					

C. F. Andrews

19-					19-				
Mar	4	M. J. Sales	150.00	-	Mar	10	Cash	150.00	-
	29	M. J. Sales	140.00	-					
			290.00	-					

Ellsworth & Co.

19-					19-				
Mar	9	M. J. Sales	120.00	-	Mar	15	Cash Sale 4/1-	120.00	-
	13	M. J. Sales	200.00	-			Cash 500	150.00	-
			320.00	-		21	Notes Rec. 1000	270.00	-

Foster & Flynn

19-					19-				
Mar	15	M. J. Sales	300.00	-	Mar	31	Notes Rec. (30 days)	200.00	-

Merchandise Inventory

(Page 2)

19-									
Mar	1	R. B. Duncan, Invoice	300.00	-					

Furniture & Fixtures.

19-	Mar 18 Standard Fixture Co.	1000-	
	Notes Payable		
	Mar 25 Mdtl. Bk. (30 day)	1600-	
	L. E. Howe		
19-	Mar 14 Cash	700-	Mar 7 Mdtl. Bk.
			15 Mdtl. Bk.
			1000-
			900-
			1000-
	Standard Fixture Co.		
19-	Mar 28 Cash	1000-	Mar 18 Furn. & Fix. (store)
			1000-
	Dean & Johnson		
19-	Mar 30 Mdtl. Bk. (ret'd)	400-	Mar 29 Mdtl. Bk.
			1500-
	Robert Duncan Capital		
	Mar 1 Cash	4000	
	Mar 1 Mdtl.	3000	7000-
	Robert Duncan Drawing		
19-	Mar 26 Cash	50-	(Page 3)
	Merchandise Purchases		
19-	Mar 7 L. E. Howe on a/c	1000-	Mar 30 Dean & Johnson (invoice)
	15 L. E. Howe on a/c	900-	
	16 Cash	2500-	
	23 Dean & Johnson on a/c	1500-	
	25 Mdtl. Bk. (30 day)	1600-	
		7500-	

QUESTIONS

1. What is the purpose of substituting individual customers' names for the title, Accounts Receivable, in the equation?
2. What is the purpose of substituting individual creditors' names for the title, Accounts Payable?
3. What is the purpose of expanding the proprietor's capital title?
4. What are some of the titles for the additional title required to expand the proprietor's capital title?
5. After transferring the net profit to the Drawing title, under what conditions will the balance in this title
 - (a) Be transferred to the Capital title?
 - (b) Not be transferred to the Capital title?
6. What is the result of horizontal expansion of the equation?
7. What is an account?
8. Describe the standard form of account.
9. Why is unit ruling desirable in the dollar column?
10. What is the ledger?
11. (a) What is a T account? (b) Skeleton ledger?
12. Explain debit, credit, debtor, creditor.
13. (a) What are the abbreviations for "debtor" and "creditor?"
(b) To what other words do they apply?
14. What is a trial balance?
15. (a) What is a trial balance of totals?
(b) How is it obtained?
16. (a) What is a trial balance of differences?
(b) How is it obtained?
17. Explain the uses of the trial balance.

PROBLEMS

1. (a) Expand the following Accounts Receivable title by substituting the individual titles.

ACCOUNTS RECEIVABLE

<i>Increases</i>		<i>Decreases</i>	
H. F. Ward.....	\$ 500	Dennis and Company....	\$1,000
M. D. Williams.....	700	H. F. Ward.....	500
H. F. Ward.....	600	H. F. Ward.....	300
Dennis and Company....	1,000	A. B. Nichols.....	50
A. B. Nichols.....	250	H. F. Ward.....	800
Dennis and Company....	900		
H. F. Ward.....	1,500		

(b) Balance the title of H. F. Ward, showing in one item the amount he owes us on account.

2. (a) Expand the following by substitution.

ACCOUNTS PAYABLE

<i>Decreases</i>		<i>Increases</i>	
Wilson and Wood.....	\$ 200	Charles Hughes.....	\$1,200
John Davies.....	400	John Davies.....	700
Charles Hughes.....	1,200	Wilson and Wood.....	500
John Davies.....	1,000	John Davies.....	1,000
		National Manufacturing Company.....	800
		John Davies.....	600

(b) Balance the individual title, John Davies, showing in one item the amount we owe him on account.

3. Expand the following Capital title into two titles—a Drawing and a Capital account.

WALTER PAGE, CAPITAL

(2) Withdrew Cash for personal use.....	\$200	(1) Investment.....	\$8,000
(3) Withdrew Merchandise for personal use.....	75	(4) Additional Investment.....	1,000
(5) Withdrew Cash for personal use.....	100	(6) Net Profit.....	1,985

4. Prepare a Drawing and a Capital title from the following: Imagine the entries in the other titles affected, such as Cash, Merchandise, etc.

- Arthur Dean began business with \$6,000 in cash and \$4,000 in merchandise.
- He withdrew cash for personal use \$125.
- He sold merchandise for cash \$1,000.
- He withdrew merchandise for personal use \$60.
- He made an additional investment of \$2,000 in cash.
- He bought a delivery car for \$1,200 in cash.
- His net profit for 3 months was \$2,275.

5. (a) Rule one sheet of letter-size paper in the horizontally expanded form of the equation (standard ledger ruling) and record the following transactions. Open accounts arranged in the proper order, and allow lines as follows: Cash 7, Merchandise Inventory 3, Merchandise Sales 5, F. E. Hayes 3, Expense 4, Fred L. Miner, Drawing 3, Fred L. Miner, Capital 4.

February, 19—

1. Fred L. Miner began business with \$2,000 cash and \$3,000 in merchandise.
4. Sold merchandise, on account, to F. E. Hayes \$1,400.
7. Sold merchandise for cash \$500.
9. Paid clerks' salaries in cash \$200.

(b) Foot each account entering total debits and credits in small pencil figures.

(c) Prepare a trial balance of totals.

6. (a) The following transactions represent a continuation of the business of Fred L. Miner. Record in the ledger used for Problem 5 and open an account for Merchandise Purchases, allowing three lines.

February, 19—

10. Bought merchandise for cash \$1,800.
12. Received check for \$500, on account, from F. E. Hayes.
14. Sold merchandise to M. E. Keats for cash \$500.
15. Paid \$20 cash for postage stamps.
16. Withdrew \$60 in cash for personal use.

(b) Foot in pencil each account again and prepare a trial balance of totals.

(c) Enter in pencil the footings of debits and credits in the Explanation column on the larger side of each account and find the difference.

(d) Prepare a trial balance of differences.

CHAPTER XII

THE FINANCIAL STATEMENTS—CLOSING THE LEDGER

Purpose of Chapter.—

1. The balance sheet and profit and loss statement.
2. Closing the ledger.
3. The post-closing trial balance.

The Financial Statements.—The information gathered in the ledger and condensed into the trial balance does not show the financial condition or the sources of changes in financial condition in a form readily understood. Therefore two financial statements must be prepared: (1) the balance sheet, Form 4 (a) and (b), and (2) the profit and loss statement, Form 5.

1. The Balance Sheet.—This is but another name for the statement of assets, liabilities, and capital, or the financial statement. The title “balance sheet” was doubtless derived from the fact that when the information it contains is presented in the form of a horizontal equation, $\text{Assets} = \text{Liabilities} + \text{Capital}$, the two sides are equal, i.e., they balance. There are two forms of balance sheet: (1) the report form, and (2) the account, or technical, form.

In the report form, Form 4 (a), the information is shown in accordance with the equation

$$\text{Assets} - \text{Liabilities} = \text{Capital}$$

In the account form, Form 4 (b), the information is set up according to the equation

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

The first form with which the student is already familiar will be continued under its new title, balance sheet. Illustration of the second is given on page 166.

2. The Profit and Loss Statement.—This title has been explained previously. We shall repeat, however, that the purpose of this statement (see Form 5) is to show the sources of the changes in capital that have occurred as a result of operating the business during the current period. In other words, it shows the causes of increases and decreases in assets and liabilities that have resulted in changes in capital. It is thus a *cause* or *source* statement summarizing the changes in capital.

Two Plans of Procedure.—Two plans may be followed in preparing the statements. Under the first plan all adjustments of assets, liabilities, and capital are first made in the accounts in the ledger—called “adjusting” and “closing” the ledger—after which the balance sheet and profit and loss statement are prepared. Under the second plan the statements are prepared first and the ledger is then adjusted and closed. Under this plan the trial balance is used as the starting point because it is a summary of the ledger. The information contained in the trial balance together with the list of inventories will enable one to prepare the balance sheet, showing the assets, liabilities, and capital as of a given date, and the profit and loss statement, showing the sources of all changes in capital.

Advantage of Preparing Statements First.—If in closing the ledger before preparing the statements an error should occur through omitting an item, entering figures incorrectly, or through any other cause, the error although corrected will remain on the books for all time as evidence of careless work. This may be avoided by preparing the balance sheet and statement of profit

and loss first; then, if an error occurs, adjustments can be made and correct statements prepared, since they are not an integral part of the ledger. The profit and loss statement can thus be made to serve as a guide in closing the ledger and so enable one to detect errors in time to avoid making them in the ledger. This is especially important while one is learning the subject, because it will save time and produce a feeling of confidence in proving the work before making the final record.

Preparing the Statements.—A convenient method in working with a trial balance and inventories is to rule two columns on the trial balance, just to the left of the Folio column, writing “B/S” for balance sheet and “P/L” for profit and loss statement at the top as indicated on the trial balance and inventories on page 164. In the B/S column opposite each account that will appear in the balance sheet, write A for Assets, L for Liabilities, and C for Capital. In the P/L column write the initial letter of the section in which the item will be used in the profit and loss statement, viz., S for Sales, CG for Cost of Goods Sold, and E for Expense. Items having letters in both columns will be used in both statements, and items marked “X” on the line indicate that adjustments in the amount must be made before entering in the section of the statement indicated.

The individual customers’ accounts will, of course, be collected in a schedule of accounts receivable and only the totals entered in the balance sheet as Accounts Receivable; and the same procedure will be followed for individual creditors, listing the total as Accounts Payable.

Every item in the balance sheet should be supported by a schedule explaining it in detail. This was done in the report on the condition of the business of Henry Martin in Chapter V, page 51. The only schedules necessary in this and succeeding problems are the two for customers and creditors—unless additional schedules are specifically called for.

With all items marked to indicate the statement and the

section of the statement in which they are to appear, little difficulty should be experienced in preparing correct statements. The trial balance, additional information, and statements follow:

ROBERT DUNCAN, TRIAL BALANCE, MARCH 31, 19—

P/L B/S

	A	1	Cash.....	\$ 2,270	-		
	A	1	Notes Receivable.....	3,000	-		
	A	1	C. F. Andrews.....	1,400	-		
	A	1	Ellsworth and Company.....	500	-		
	A	1	Foster and Flynn.....	1,000	-		
C	G	2	Merchandise Inventory 3/1/—.....	3,000	-		
×	A	2	Furniture and Fixtures.....	1,000	-		
	L	2	Notes Payable.....			\$ 1,600	-
	L	2	L. E. Howe.....			1,200	-
	L	2	Dean and Johnson.....			1,100	-
	C	2	Robert Duncan, Capital.....			7,000	-
	C	3	Robert Duncan, Drawing.....	50	-		
C	G	3	Merchandise Purchases.....	7,100	-		
S		3	Merchandise Sales.....			9,100	-
E	×	3	Rent.....	400	-		
E	×	3	Expense.....	280	-		
				\$20,000	-	\$20,000	-

ADDITIONAL INFORMATION

P/L	B/S	Inventories, March 31, 19—	
C/G	A	Merchandise in stock.....	\$3,200 -
E		Furniture and Fixtures decreased in value through use 2%	
	A	Rent paid in advance 1 month.....	200 -
	A	Expense: Miscellaneous supplies unused.....	50 -

Additional Information Needed.—The trial balance gives only the information on the ledger. It has been pointed out that some information—e.g., the cost of goods sold—is not usually recorded

at the time each transaction takes place, because of the expense involved in securing the information at that time. This information is secured, however, at the close of the fiscal period. The inventory of goods unsold is taken, the unused portion of all expense purchases is determined, and the amount of the decrease in value of the various assets is calculated. For Robert Duncan's business, this information is as follows:

ROBERT DUNCAN

BALANCE SHEET

March 31, 19—

Assets:		
Cash	\$2,270	—
Notes Receivable	3,000	—
Accounts Receivable (Schedule 1)	2,900	—
Merchandise Inventory	3,200	—
Rent Prepaid	200	—
Expense Inventory	50	—
Furniture and Fixtures	980	—
Total		\$12,600 —
Liabilities:		
Notes Payable	\$1,600	—
Accounts Payable (Schedule 2)	2,300	—
Total		3,900 —
Capital:		
Robert Duncan, Investment	\$7,000	—
Net Profit	\$1,750	
Less: Withdrawals	50	
Net Increase in Capital	1,700	—
Total		\$ 8,700 —

Account Form.—

ROBERT DUNCAN

BALANCE SHEET

March 31, 19—

Assets:		Liabilities:	
Cash.....	\$ 2,270	Notes Payable.....	\$ 1,600
Notes Receivable.....	3,000	Accounts Payable (Schedule 2).....	2,300
Accounts Receivable (Schedule 1).....	2,900	Total Liabilities.....	\$ 3,000
Merchandise Inventory.....	3,200	Capital:	
Rent Prepaid.....	200	Robert Duncan, Investment....	\$7,000
Expense Inventory.....	50	Add: Net Profit.....	\$1,750
Furniture and Fixtures.....	980	Less: Withdrawals.....	50
		Total Capital.....	8,700
Total Assets.....	\$12,600	Liabilities and Capital.....	\$12,600

Form 4. (b) Balance Sheet—Account Form

The account form of balance sheet explained is shown on the preceding page. The student will understand that a business concern adopts for use either one form or the other, both forms never being used by any one business. An account form of the Robert Duncan balance sheet (Form 4b) is used here only for the purpose of illustration.

ROBERT DUNCAN

STATEMENT OF PROFIT AND LOSS

For the month ended March 31, 19—

Sales		\$9,100 -
Cost of Goods Sold:		
Purchases	\$7,500	
Less: Returned Purchases	400	
Net Purchases	\$ 7,100 -	
Add: Inventory 3/1/—	3,000 -	
Total Cost of merchandise available for sale ..	\$10,100 -	
Less: Inventory 3/31/—	3,200 -	
Cost of Goods Sold		6,900 -
Gross Profit on Sales		\$2,200 -
Expenses:		
Rent	\$ 200 -	
Expense	230 -	
Furniture and Fixtures (2% decrease)	20 -	
Total		450 -
Net Profit		\$1,750 -

Form 5. Statement of Profit and Loss

Inter-relation of the Two Statements.—Note that the Robert Duncan balance sheet cannot be proved until the Net Profit—the last item in the Capital section—has been determined in the profit and loss statement. Capital is always the excess of assets over

liabilities. On March 31, Duncan's capital was \$8,700. Since his capital investment on March 1 was \$7,000, it has increased \$1,700 due to profits less withdrawals. Since a record has been kept on the ledger of all changes in assets and liabilities affecting capital, this record may be compared with the balance sheet to prove its correctness. The items which have changed capital are indicated in the P/L column of the trial balance on page 164 and are summarized in the statement of profit and loss on page 167. The amount of net profit or net increase in capital shown by this statement must be the same as that shown by the balance sheet. This matching of the one against the other is considered a good proof of the mechanical accuracy of both statements. A difference between these two figures is evidence of an error at some place.

The error must be located before either statement can be stated to be correct. Had each change in capital been recorded, as it occurred, in Duncan's Capital account, that account would have to prove against the excess of assets over liabilities. Since, as a matter of convenience in recording and of better information as to business operations these changes have been kept in other accounts, these other accounts must first be summarized by means of the profit and loss statement before the net change in Duncan's capital can be determined and his capital at the close of the period (March 31) known. Thus bookkeeping, by means of the trial balance and the two financial statements, provides adequate proof of the mathematical accuracy of the record.

Closing the Ledger.—The purpose of closing the ledger is to clear all accounts of changes that affect capital and to prepare them to record increases and decreases during the next period. This is done by first recording all items of this period not yet recorded and by correcting all errors which the trial balance or other means have brought to light. Then the accounts which have recorded the day-to-day increases and decreases in capital must be transferred to the Profit and Loss account or summary.

From the Profit and Loss account the net increase (or decrease) in capital is transferred to the proprietor's Drawing account, the balance of which is then transferred to his Capital account. The ledger (equation) will then show the same financial condition as the balance sheet.

Note that the Profit and Loss *account* serves the same purpose *in* the ledger that the profit and loss *statement* serves *outside* the ledger, in summarizing the capital changes. It is because the *statement* summarizes the changes *outside* the ledger and proves its accuracy by checking its results against that shown by the balance sheet, that it is best to make the statements first and so free the ledger record from errors that might be made if the summary were first made *in* the ledger.

Having made the statements first and proved their accuracy, we shall now show the entries necessary to close the ledger. These are numbered from 1 to 15 and should be traced by number and date to the various accounts affected (see Duncan's ledger beginning on page 172) and should also be compared with the statement of profit and loss on page 167. Remember that the Merchandise Trading account is used to determine: (1) the cost of goods sold, and (2) the gross profit on sales. This is accomplished by debiting and crediting the account to bring about the same additions and subtractions as are shown in the Cost of Goods Sold section of the statement of profit and loss. Thus entry 1 below, transfers to Merchandise Trading the net purchases shown by the Merchandise Purchases account in the ledger and also used in the statement, \$7,100. Entry 2 adds the inventory of March 1 to the amount of net purchases in the Merchandise Trading account. Entry 3 subtracts, by means of the credit entry, the inventory of March 31, the balance of the Merchandise Trading account now showing the cost of the goods sold. In this way the student by following the statement of profit and loss as a guide should work out the effect of each of these fifteen entries to Duncan's ledger which, for convenience of reference, is set up again on pages 172 to 175.

1. Credit Merchandise Purchases \$7,100 and debit Merchandise Trading \$7,100.

To transfer the net cost of merchandise purchased during March to Merchandise Trading to find the total cost of merchandise available for sale during the month.

2. Credit Merchandise Inventory (old account) \$3,000 and debit Merchandise Trading \$3,000.

To transfer the cost of the inventory of merchandise at the beginning of the month to Merchandise Trading account for the purpose of finding the total cost of merchandise available for sale during the month.

Note: The term "old account" indicates the account before the total rulings are made, and "new account" indicates the same account below the total rulings ready to receive the new period's record.

3. Credit Merchandise Trading \$3,200 and debit Merchandise Inventory (new account) \$3,200.

To deduct the cost of merchandise unsold of \$3,200 (called Inventory at the end) from the total cost of merchandise for the purpose of finding the cost of merchandise sold and to state the asset of merchandise remaining unsold.

4. Credit Merchandise Trading \$6,900 and debit Merchandise Trading \$6,900 below the ruling, that is, balance Merchandise Trading account.

To deduct the cost of merchandise sold (\$6,900) from the total cost of merchandise for the purpose of separating the asset sold from the asset unsold so that the gross profit on sales may be obtained.

5. Debit Merchandise Sales \$9,100 and credit Merchandise Trading \$9,100.

To transfer the total of goods sold during the month to Merchandise Trading account for the purpose of finding the amount of the gross profit on sales.

6. Debit Merchandise Trading \$2,200 and credit Profit and Loss \$2,200.

To transfer the gross profit on sales to Profit and Loss for the purpose of showing the gross increase in capital as a result of selling merchandise.

7. Credit Furniture and Fixtures (old account) \$20 and debit Profit and Loss \$20.

To transfer the amount of furniture and fixtures consumed to Profit

and Loss for the purpose of showing the amount to be deducted from the gross profit.

8. Credit Furniture and Fixtures (old account) \$980 and debit Furniture and Fixtures (new account) \$980, i.e., balance Furniture and Fixtures account.

To state the amount of the asset, Furniture and Fixtures, remaining after deducting the amount consumed. The only advantage in making this entry is to state in one amount the value of the furniture and fixtures remaining. The word "inventory" may be used instead of "balance."

9. Credit Rent (old account) \$200 and debit Profit and Loss \$200.

To transfer the amount of rent consumed to Profit and Loss for the purpose of showing the amount to be deducted from the gross profit.

10. Credit Rent (old account) \$200 and debit Rent (new account) \$200.

To state the amount of rent remaining after deducting the amount of rent consumed.

11. Credit Expenses (old) \$340 and debit Profit and Loss \$340.

To transfer the amount of expense consumed to Profit and Loss for the purpose of showing the amount which is to be deducted from gross profit.

12. Credit Expense (old) \$50 and debit Expense (new) \$50.

To state the amount of expense remaining after deducting the amount of expense consumed.

13. Debit Profit and Loss \$1,750 and credit Robert Duncan, Drawing \$1,750.

To transfer the net profit to the proprietor's Drawing account to find the *net* increase in capital.

14. Debit Robert Duncan, Drawing \$1,700 and credit Robert Duncan, Capital \$1,700.

To transfer the net increase in capital to Robert Duncan, Capital account to show the present capital.

15. Debit Robert Duncan, Capital (old) \$8,700 and credit Robert Duncan, Capital (new) \$8,700.

To state in one amount the present capital after adding the net profit to the previous capital. Instead of using the word "balance," one of the following terms may be used: net capital, present capital, capital, net worth, present worth, net investment, present investment, etc.

Cash

19--			19--		
Mar 1	Bills Duncan Invntd	4000 -	Mar 14	C.S. Howe on a/c	700 -
10	B.D. Andrews on a/c	1500 -	16	Mdscr Sales	2500 -
15	Ellsworth & Co. on a/c	1200 -	17	Revd (unmad)	400 -
21	Ellsworth & Co. on a/c	500 -	20	Expenses (charitable)	210 -
			24	Expenses (office exp)	70 -
			26	Cash (personal use)	50 -
			28	Standard Tin Co. %	1990 -
			31	Balance	2270 -
		7200 -			7200 -
Mar 31	Balance	2270 -			

Notes Receivable

19--					
Mar 21	Ellsworth & Co. (30 day)	1000 -			
31	Forster & Flynn (30 day)	2000 -			

C. F. Andrews

19--			19--		
Mar 4	Mdscr Sales	1500 -	Mar 10	Cash	1500 -
29	Mdscr Sales	1400 -			

Ellsworth & Co.

19--			19--		
Mar 9	Mdscr Sales	1200 -	Mar 15	Cash Sales 500	1200 -
13	Mdscr Sales	2000 -	21	Notes Rec. 1000	1500 -

Forster & Flynn

19--			19--		
Mar 15	Mdscr Sales	2000 -	Mar 31	Notes Rec. (30 day)	2000 -

Merchandise Inventory

19--			19--		
Mar 1	Bills Duncan Invntd	2000 -	Mar 31	Mdscr Trading	2000 -
Mar 31	Mdscr Trading	2000 -			

Furniture & Fixtures.

19-	Mar 15	Standard Fixture Co. a/c	1000-	19-	Mar 31	Profit & Loss ⁽⁷⁾		20-
					31	Balance ⁽⁸⁾		980-
			1000-					1000-
19-	Mar 31	Balance ⁽⁸⁾	980-					

Notes Payable

19-
Mar 25 Moline Bus. (3rd ed.) 1600-

L. E. Howe

19-	Mar 14	Cash	700-	19-	Mar 7	Moline Bus.	1000-
					15	Moline Bus.	900-
							1900-

Standard Fixture Co.

19-	Mar 28	Cash	1000-	19-	Mar 18	Fun & Fix (store)	1000-
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Deane & Johnson

19-	Mar 30	Moline Bus. (paid)	400-	19-	Mar 28	Moline Bus.	1500-
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Robert Duncan, Capital

19-	Mar 31	Balance ⁽¹⁵⁾	8700-	19-	Mar 1	Cash 4000 Moline 3000	7000-
					31	Drawing a/c ⁽¹⁶⁾	1700-
						Increase in capital	
			8700-				8700-
					Mar 31	Balance ⁽¹⁵⁾	8700-

Robert Duncan, Drawing

19-	Mar. 26	Cash, personal use	50 -	19-	Mar. 31	Ret. (Net Profit)	1750 -
	31	R. Duncan, C/A Ret.					
		increase in capital)	1700 -				
			1750 -				1750 -

Merchandise Trading

19-	Mar. 31	Purchases	7100 -	19-	Mar. 31	Inventory, bal.	3200 -
	31	Inventory, 2/1-	3000 -		31	Balance (cost of goods sold)	6900 -
			10100 -				10100 -
19-	Mar. 31	Balance of goods sold)	6900 -	19-	Mar. 31	Sales	9100 -
	31	Ret. (Gross Profit)	2200 -				9100 -
			9100 -				9100 -

Profit & Loss

19-	Mar. 31	Trans. & Tr.	20 -	19-	Mar. 31	Merch. Trading	
	31	Rent	200 -			(Gross Profit)	2200 -
	31	Expense	230 -				
	31	R. Duncan, C/A					
		(Net Profit)	1750 -				
			2200 -				2200 -

Merchandise Purchases

19-	Mar. 7	C. E. Howe on a/c	1000 -	19-	Mar. 30	Mar. & Johnson (inv. 21st)	1100 -
	15	C. E. Howe on a/c	900 -		31	Merch. Trading	7100 -
	16	Cash	2500 -				
	23	Mar. & Johnson on a/c	1500 -				
	25	Notes Pay. (30 day)	1600 -				
			7500 -				7500 -

Merchandise Sales.

19-	Mar. 31	(5) <i>Merch. Trading</i>	9100 -	19-	Mar. 4	65 <i>Andrews on a/c</i>	1500 -
						9 <i>Ellsworth & Co. on a/c</i>	1200 -
						13 <i>Ellsworth & Co. on a/c</i>	2900 -
						18 <i>Trute & Ryan on a/c</i>	3000 -
						29 <i>65 Andrews on a/c</i>	1400 -
			9100 -				9100 -
<i>Receipts</i>							
19-	Mar. 17	(6) <i>Cash (revenue)</i>	400 -	19-	Mar. 31	(9) <i>Profit & Loss</i>	200 -
			400 -			31 <i>Balance</i>	200 -
							400 -
19-	Mar. 31	(10) <i>Balance</i>	200 -				
<i>Expenses</i>							
19-	Mar. 20	(11) <i>Cash (disburse)</i>	210 -	19-	Mar. 31	(11) <i>Profit & Loss</i>	230 -
		24 <i>Cash (office exp.)</i>	70 -			31 <i>Balance</i>	50 -
			280 -				280 -
19-	Mar. 31	(12) <i>Balance</i>	50 -				

The Post-Closing Trial Balance.—In closing the ledger, errors may be made in recording the transfers from one account to another which will throw the ledger out of balance, i.e., the equation will not be in equilibrium. To test the accuracy of the closing transfer entries and to afford a means of comparing the assets, liabilities, and capital in the balance sheet with the same items in the ledger (equation), it is customary to prepare another trial balance *after closing the ledger*, called a “trial balance after closing,” or a “post-closing trial balance.” It is prepared in exactly the same way as other trial balances; i.e., all accounts that balance are omitted and only the debit or credit balances of the others are shown. The post-closing trial balance of Robert Duncan’s ledger is given on the next page.

ROBERT DUNCAN, POST-CLOSING TRIAL BALANCE, MARCH 31, 19—

1	Cash.....	\$ 2,270	—		
1	Notes Receivable.....	3,000	—		—
1	C. F. Andrews.....	1,400	—		
1	Ellsworth and Company.....	500	—		
1	Foster and Flynn.....	1,000	—		
2	Merchandise Inventory.....	3,200	—		
2	Furniture and Fixtures.....	980	—		
2	Notes Payable.....			\$ 1,600	—
2	L. E. Howe.....			1,200	—
2	Dean and Johnson.....			1,100	—
2	Robert Duncan, Capital.....			8,700	—
3	Rent.....	200	—		
3	Expense.....	50	—		
		\$12,600	—	\$12,600	—

Comparison with the Balance Sheet.—The balance sheet and the post-closing trial balance should now be compared. The balance sheet shows the present amount of each of the assets, liabilities, and capital, as well as the total amount of each group. The post-closing trial balance shows them as they are arranged in the ledger for the purpose of collecting increases and decreases during the next period. To test the totals of the post-closing trial balance, see if they agree with the totals of the balance sheet. Since the debit side of the ledger after closing shows only asset balances, the total of the debits of the post-closing trial balance should be the same as the total assets in the balance sheet. Similarly, since liabilities and capital appear as credits in the ledger, the sum of the liabilities and capital in the balance sheet should be the same as the credit total of the post-closing trial balance. Every item in the balance sheet should be compared with the corresponding item in the post-closing trial balance. In comparing Accounts Receivable the sum of the debit balances of customers' accounts in the post-closing trial balance should agree with the item, Accounts Receivable, on the

balance sheet. In like manner the sum of the individual creditors' balances should agree with the Accounts Payable item in the balance sheet. After proving the ledger by this comparison, it is considered correct and ready to receive the next period's record of business operations.

Ruling Accounts.—In all horizontal ruling in the ledger single lines are ruled across the money columns to indicate that all amounts above the lines are to be added, the totals appearing just below the lines. Note that the lines across the debit and credit money columns of an account are always on the same horizontal line or level. Double lines indicate that the debit and credit amounts in the account above the ruling are equal and that portion of the account is complete or in balance. The double lines are generally ruled just under the totals and usually cross all vertical columns except the explanation columns. There are many other forms of ruling, but none so generally used as this, which is the standard form. It will be used throughout this work. The single lines should be ruled on the last line on which an amount of money appears and the double lines usually one line lower. Note the ruling in the following accounts.

Although frequently done, it is not necessary to "balance" the Cash account, or any other account that does not contain an increase or decrease in capital. The Cash account in this ledger is balanced to illustrate how it appears when balanced. If the account is "balanced," it states in one amount the amount of the asset remaining with which to begin the operations of the next period.

Merchandise Inventory account shows double lines only. Since there is only one item on each side, it is not necessary to rule single lines for adding—the item is the total.

The Standard Furniture Company account is ruled the same as the Merchandise Inventory account, but it is now ended—dead—and, of course, does not appear in the trial balance.

Formerly red ink was used for all horizontal ruling. There is no particular advantage in this, however, black ink serving equally well. Time is wasted in changing from one pen to another. The tendency at present is to avoid the use of red ink or any color other than that used to record the regular entries.

Use of Dashes in Cents Column.—If the cents column is left blank when an amount is entered in the dollars column, one cannot tell whether the amount contained only dollars, or dollars and cents, the cents being omitted through error. To indicate that there are no cents in the amount, various devices are used. Some write two ciphers (00) in the cents column; others place a cross (X) there and still others enter a dash (—). The objection to ciphers is that they may be poorly made and thus cause errors by being mistaken for other figures. The same objection applies to the cross. The dash is easily and quickly made, does not interfere with addition, and cannot be mistaken for some other figure. It will accordingly be used throughout this work.

QUESTIONS

1. (a) What is a balance sheet?
(b) From what may it have derived its name?
2. (a) Name the two forms of balance sheet?
(b) Explain the arrangement of the information in each.
3. What is the purpose of a profit and loss statement?
4. Why is "financial statement" objectionable when used as a title in place of "balance sheet"?
5. What is meant by "closing the ledger"?
6. Explain the two plans of procedure in preparing the statements.
7. What are some of the advantages of preparing the financial statements before closing the ledger?
8. What information in addition to that contained in the trial balance is necessary to prepare the financial statements?
9. Explain a plan for preparing the financial statements from the trial balance and inventories or additional information.
10. Explain the inter-relation between the balance sheet and profit and loss statement.

11. (a) Does the agreement of the *net profit* as shown on the profit and loss statement and the balance sheet prove that the accounting has been correctly done? Why?

(b) What does the agreement prove?

12. What is the purpose of closing the ledger?

13. What two things are shown on the ledger by means of the Merchandise Trading account?

14. (a) What accounts are transferred to the Merchandise Trading account?

(b) Into what account is the Merchandise Trading account closed?

15. Prepare a Merchandise Trading account. Provide the names and amounts and show the account closed.

16. (a) What accounts are transferred to the Profit and Loss account?

(b) Into what account is the Profit and Loss account closed? Why?

17. Prepare a Profit and Loss account. Provide the names and amounts and show the account closed.

18. (a) What does the Drawing account contain?

(b) To what account is the debit or credit excess in this account usually transferred?

(c) Under what conditions would the debit or credit excess in this account not be transferred to another account?

19. Prepare a Drawing account? Provide the items and show the account closed: (a) with a credit excess, and (b) with a debit excess.

20. (a) What is the purpose of closing the Capital account?

(b) What words may be substituted for "balance" in closing this account?

21. Prepare a Capital account. Provide the items and show the account closed.

22. Name the steps taken in closing the ledger, giving the accounts affected in regular order?

23. (a) What is a post-closing trial balance?

(b) Why is it prepared?

(c) What other names are given to this trial balance?

24. With what financial statement can the post-closing trial balance be compared?

25. (a) Why must the total debits in the post-closing trial balance agree with the total assets in the balance sheet?

(b) With what must the credits in this trial balance agree? Why?

26. With what accounts in the trial balance must the item of Accounts Receivable in the balance sheet agree? Accounts Payable?

27. (a) What is the purpose of ruling single horizontal lines in an account?
(b) Across what columns do they extend?
28. (a) What is the purpose of ruling double horizontal lines in an account?
(b) Across what columns do they extend?
29. How should each of the following accounts be ruled?
(a) An account containing only one debit and credit, both the same amount.
(b) An account containing four debits and two credits, having equal totals.
30. What is meant by "balancing" an account?
31. Is the use of red ink necessary? Why?
32. Why are dashes (—) used in the cents column?

PROBLEMS

1. (a) Rule one sheet of letter-size paper in the ledger form and number the pages "1" and "2"; and then record the following transactions: Open accounts arranged in proper order and allow lines as follows: Cash 9, Merchandise Inventory 4, Merchandise Purchases 6, Merchandise Sales 6, Furniture and Fixtures 3, John C. Scovill 4, Roy M. Martin 3, Expense 5, Henry L. Holt, Capital 7, Merchandise Trading 8, Profit and Loss 5.

June, 19—

1. Henry L. Holt began business with \$5,000 in cash; \$6,000 in merchandise; and \$1,000 in furniture and fixtures.

3. Sold merchandise on account to John C. Scovill \$2,000.

5. Sold merchandise to T. E. Davis for cash \$500.

6. Paid cash of \$400 for clerks' salaries.

7. Bought merchandise on account from Roy M. Martin \$1,500.

8. Sold merchandise on account to John C. Scovill \$200.

10. Received cash from John C. Scovill paying for merchandise purchased June 3, \$2,000.

12. Bought merchandise from Roy M. Martin for cash \$2,500.

14. Paid cash of \$400 for clerks' salaries.

15. Bought merchandise from Harry Day for cash \$750.

(b) Pencil foot each account and enter differences in small pencil figures.

(c) Prepare a trial balance of differences.

(d) On June 15 there was merchandise unsold of \$9,200. All of the expense assets were consumed.

(e) From the trial balance and inventory prepare:

1. Balance sheet
2. Statement of profit and loss

(f) Close the ledger and prepare a post-closing trial balance.

2. (a) Record the following transactions in the ledger. One sheet of ledger paper is required. Open accounts arranged in proper order and allow lines as follows: Cash 6, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 6, Daly McCoy 3, Horace Newman 3, Furniture and Fixtures 5, Expense 3, Crosby Furniture Company 3, Laidlaw and Gordon 3, Davis L. Crowe, Capital 6, Merchandise Trading 8, Profit and Loss 5, Davis L. Crowe, Drawing 4.

January, 19—

1. Davis L. Crowe began business with \$3,000 cash and \$5,000 in merchandise.
4. Bought furniture and fixtures of Crosby Furniture Company, on account, \$1,100.
5. Sold merchandise, on account, to Daly McCoy \$1,200.
7. Sold merchandise of \$800 for cash.
10. Paid clerks' salaries in cash \$200.
12. Sold merchandise, on account, to Horace Newman \$985.
14. Daly McCoy returned \$225 of the merchandise purchased January 5, as unsatisfactory.
15. Purchased merchandise from Laidlaw and Gordon, on account, \$1,800.
17. Withdrew cash for personal use \$70.

(b) Prepare a trial balance of differences. Make sure you have entered the small pencil footings and that you indicated the difference in small pencil figures on the larger side of each account.

(c) On January 15 there was merchandise unsold of \$4,765. All of the expense asset (\$200) was consumed in conducting the business, and furniture and fixtures decreased in value \$22 on account of use.

(d) From the trial balance and inventory prepare:

1. Balance sheet
2. A statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

3. (a) Record the following transactions in the ledger. One sheet of ledger paper is required. Open accounts arranged in proper order and allow lines as follows: Cash 10, Merchandise Inventory 5, Furniture and

Fixtures 6, Merchandise Sales 6, Merchandise Purchases 5, Mason and Dunn 3, Dyson and Reed 3, Expense 4, Robert Larson and Company 3, James L. Oxford, Capital 5, Merchandise Trading 8, Profit and Loss 6, James L. Oxford, Drawing 5.

March, 19—

1. James L. Oxford began business with \$5,000 cash and \$5,000 in merchandise.
2. Bought furniture and fixtures from Carpenter Furniture Company for cash \$1,200.
3. Paid cash of \$200 to Jamison Realty Company for rent of store for month of March.
7. Sold merchandise to Mason and Dunn on account \$2,500.
10. Paid cash of \$600 for salaries.
14. Sold merchandise to Dyson and Reed on account \$800.
20. Bought merchandise on account from Robert Larson and Company \$3,000. Withdrew for personal use, cash \$40; merchandise \$50.
24. Bought merchandise for cash from D. E. Hughes \$1,400.
28. Sold merchandise to Mason and Dunn for cash \$900.
31. Paid cash of \$250 to Burroughs Adding Machine Company for an adding machine.

(b) Enter totals and differences in small pencil figures, after which prepare a trial balance of differences.

(c) On March 31 there was merchandise unsold of \$6,500. All of the expense assets were consumed and \$12 of the furniture and fixtures were consumed in operating.

(d) From the trial balance and inventory prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

4. (a) Record the following transactions in the ledger. One sheet of ledger paper is required. Arrange the accounts in the proper order and give each account the specified number of lines: Cash 10, William C. Glasgow 3, Nagel Electric Co. 3, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 7, Rent 3, Expense 6, Furniture and Fixtures 6, Huntington Furniture Co. 3, Lexington Sales Co. 3, James H. Hallowell, Capital 7, James H. Hallowell, Drawing 5, Merchandise Trading 8, Profit and Loss 5.

December, 19—

15. James H. Hallowell started business with cash of \$2,500 and merchandise of \$4,750.
16. Bought furniture and fixtures from Huntington Furniture Company, on account, \$575.
17. Paid cash for drayage \$3. Paid cash for rent \$20.
18. Sold merchandise to William C. Glasgow, on account, \$1,574.
19. Paid cash for salaries \$275.
21. Sold merchandise to H. N. Fernald for cash \$820.
23. Returned a desk purchased from Huntington Furniture Company on the 16th, because it was broken when delivered, \$32.
24. Made sundry sales for cash \$1,720.
26. Paid cash for postage \$20.
28. Bought a typewriter from Remington Typewriter Company for cash \$100. Withdrew merchandise for personal use \$55.
29. Bought merchandise from the Lexington Sales Company, on account, \$2,200.
30. Withdrew cash for personal use \$60. Paid cash for January rent in advance \$40.
31. Sold merchandise to Nagel Electric Company, on account, \$985.

(b) Enter differences in small pencil figures, after which prepare a trial balance.

(c) Merchandise inventory on December 31 was \$2,000. All expense assets were consumed except prepaid rent of \$40.

(d) Prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

5. (a) Record the following transactions in the ledger. Two sheets of ledger paper are required. Arrange the accounts in the proper order and give each account the specified number of lines: Cash 11, Notes Receivable 3, Frank E. Hess 3, Merchandise Inventory 4, Merchandise Purchases 5, Merchandise Sales 5, Furniture and Fixtures 6, Securities 5, Rent 6, Expense 5, H. L. Pogue 5, L. M. Carpenter and Company 3, George W. McAlpine Company 3, Underwood Typewriter Company 3, Richard L. Winslow, Capital 7, Merchandise Trading 8, Profit and Loss 7, Richard L. Winslow, Drawing 6.

October, 19—

1. Richard L. Winslow started business with cash of \$5,000; \$3,000 in stocks and bonds; merchandise \$2,000.

2. Paid rent to December 31, \$600 cash.
3. Bought merchandise from H. L. Pogue, on account, \$5,000.
4. Bought furniture and fixtures from L. M. Carpenter and Company, on account, \$1,300.
6. Paid cash for express and drayage \$25.
8. Sold merchandise to Frank E. Hess, on account, \$3,000.
9. Returned merchandise to H. L. Pogue, because it was damaged in transportation, \$500. Made an additional investment of \$2,000 cash in the business.
10. Sold merchandise for cash \$1,200.
11. Bought merchandise from the George W. McAlpine Company, on account, \$1,000.
13. Paid H. L. Pogue the balance of his account in cash \$4,500.
15. Bought a new typewriter from the Underwood Typewriter Company, on account, \$95.
18. Frank E. Hess paid his account by giving his 30-day note for \$3,000.
25. Paid the George W. McAlpine Company \$1,000 for invoice of the 11th.
30. Paid cash for miscellaneous expense \$100.
31. Withdrew for personal use: cash \$100; merchandise \$80.

(b) Enter totals and differences in small pencil figures, after which prepare a trial balance.

(c) Merchandise inventory on October 31 was \$3,000. All expense assets were consumed except 2 months' rent \$400. The furniture and fixtures decreased \$13 in value in operating.

(d) From the trial balance and the above information prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

6. (a) Record the following transactions in the ledger. Two sheets of ledger paper are required. The number after the name of the account indicates the number of lines to be allowed for that account. Arrange the accounts in the proper order: Cash 11, Henry Stanley 6, B. S. Young 5, Notes Receivable 3, Merchandise Inventory 4, Merchandise Purchases 8, Merchandise Sales 9, Furniture and Fixtures 6, Rent 6, Expense 5, Barton and Company 7, Jacob Gold 3, Notes Payable 3, P. T. Barnum, Capital 6, Merchandise Trading 8, Profit and Loss 7, P. T. Barnum, Drawing 7.

June, 19—

1. P. T. Barnum began business with \$6,000 in cash, \$7,000 in merchandise, and \$1,200 in furniture and fixtures.
3. Sold merchandise to Henry Stanley, on account, \$1,400.
4. Bought merchandise from Barton and Company, on account, \$1,100.
7. Henry Stanley returned merchandise from sale of the 3d to the amount of \$200, because it was not the proper quality.
10. Sold to B. S. Young merchandise, on account, \$2,900. Sold merchandise to Henry Stanley, on account, \$1,700.
12. Bought merchandise from Jacob Gold, on account, \$2,100.
13. Paid Barton and Company by check in full for invoice of 6/4/—, \$1,100.
14. Withdrew merchandise for personal use \$40. Sold merchandise for cash \$1,500.
15. Received check from Henry Stanley in full for sale of 6/3/—, \$1,200. Bought merchandise from Barton and Company, on account, \$1,600.
16. Withdrew cash for personal use \$75.

(b) Prepare a trial balance of differences. Make sure you have entered the small pencil footings and that you indicated the difference in small pencil figures on the larger side of each account.

7. (a) The following transactions represent a continuation of the business of P. T. Barnum. Record in the ledger used for Problem 6 and open the following additional accounts: Notes Receivable 3, Furniture and Fixtures 6, Rent 6, Expense 5, Notes Payable 3, Merchandise Trading 8, Profit and Loss 7.

June, 19—

17. Paid Barton and Company by check for sale of 6/15/— \$1,600.
18. Inherited \$3,000 in cash which he invested in the business.
19. Received from B. S. Young in payment of sale of the 10th, cash \$1,900 and his 30-day note for \$1,000.
20. Paid Fulton and Company by check \$350 for rent for June and July.
21. Sold merchandise to B. S. Young, on account, \$2,100.
22. Bought merchandise from Barton and Company, on account, \$1,700.
23. Withdrew for personal use; merchandise \$35; cash \$55.
24. Paid clerks' salaries in cash \$150.

25. Returned \$300 in merchandise to Barton and Company from purchase of June 22 because a certain part of the order had been filled twice.
27. Paid cash for office supplies \$80.
28. Gave Jacob Gold 30-day note for \$1,100 in part payment of purchase of the 12th.
29. Sold merchandise to Henry Stanley, on account, \$3,000.
30. Bought merchandise from Barton and Company, on account, \$1,200.

(b) Pencil foot each account and enter differences in *small* pencil figures, after which prepare a trial balance.

(c) An inventory on June 30 showed merchandise on hand \$6,800; rent paid in advance 1 month \$175; furniture and fixtures valued at \$1,190.

(d) From the trial balance and inventories prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

8. (a) Record the following transactions in the ledger. Two sheets of ledger paper are required. Give each account the specified number of lines: Cash 15, James W. Riley 5, Merchandise Inventory 4, Merchandise Purchases 6, Merchandise Sales 9, Furniture and Fixtures 6, Rent 3, Expense 9, F. L. Lowell 3, Maurice P. Kirby, Capital 5, Maurice P. Kirby, Drawing 5.

November, 19—

1. Maurice P. Kirby began business with \$2,000 cash; \$4,000 merchandise; \$900 furniture and fixtures.
2. Paid cash for 1 month's rent \$150.
4. Sold merchandise, on account, to James W. Riley \$1,200.
7. Paid cash for clerks' salaries \$125.
10. Bought merchandise, on account, from F. L. Lowell \$1,500.
12. James W. Riley returned merchandise of \$225 because it was not the quality ordered.
13. Paid cash for advertising \$25.
14. Received check of \$975 from James W. Riley, paying for the goods purchased on the 4th less return of merchandise on the 12th.
15. Sold merchandise for cash \$850. Withdrew cash for personal use \$50.

(b) Enter totals and differences in *small* pencil figures, after which prepare a trial balance.

9. (a) The following transactions represent a continuation of the business of Maurice P. Kirby. Record in the ledger used for Problem 8 and open these additional accounts: Jonas Quibble 3, Notes Receivable 3, Delivery Equipment 3, Overland Motor Car Company 3, Harper Sales Company 3.

November, 19—

16. Paid F. L. Lowell by check in full for merchandise purchased 11/10/—, \$1,500.
17. Sold merchandise of \$1,200 to H. M. Mattingly, accepting his 30-day note in payment.
18. Bought a delivery car from the Overland Motor Car Company, on account, \$1,000.
19. Paid cash for office supplies \$65.
20. Bought merchandise from Harper Sales Company, on account, \$2,000.
21. Paid cash for clerks' salaries \$125.
22. Sold merchandise to Jonas Quibble, on account, \$1,995.
23. Returned merchandise to Harper Sales Company \$350 because of incorrect sizes. Paid personal gas bill in cash \$7.45.

(b) Enter totals and differences in small pencil figures after which prepare a trial balance.

10. (a) The following transactions represent a continuation of the business of Maurice P. Kirby. Record in the ledger used for Problems 8 and 9 and open these additional accounts: Henry T. Monroe 3, Building 3, Insurance 3, Dixon, Smith and Company 3, Mortgage Payable 3, Merchandise Trading 7, Profit and Loss 7.

November, 19—

24. Sundry sales of merchandise for cash \$2,600.
25. Bought merchandise from Dixon, Smith and Company, on account, \$2,900.
26. Bought the building he occupies from L. R. Smith Realty Company for \$12,000, paying \$2,000 cash and a mortgage on the property for \$10,000.
27. Donated \$50 in merchandise to the Salvation Army. Paid cash for miscellaneous expense \$125.
28. Received check from Jonas Quibble paying his account in full \$1,995.

20. Drew cash for personal use \$150. Sold merchandise to Henry T. Monroe, on account, \$1,300.
30. Paid cash for insurance of building from December 1, 19—, to December 1, 19—, \$150.

(b) Enter totals and differences in small pencil figures, after which prepare a trial balance.

(c) On November 30 there was merchandise unsold of \$4,046. The following expense assets were consumed in operating the business: rent \$150; clerks' salaries \$250; advertising \$10; office supplies \$25; miscellaneous expense \$125; furniture and fixtures 1% of cost price \$9.

(d) From the trial balance and inventories prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

11. (a) Record the following transactions in the ledger. Two sheets of ledger paper are required. Number the pages 1, 2, 3, 4. Arrange the accounts in the proper order and give each account the specified number of lines: Cash 10, L. D. Watterbury 3, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 6, Furniture and Fixtures 4, Real Estate 4, Taxes 5, Expense 8, Donations 3, Gray and Crosby 3, Burroughs Adding Machine Company 3, J. L. Hervey 3, Notes Payable 3, Clarence V. Dynes, Capital 6, Merchandise Trading 8, Profit and Loss 7, Clarence V. Dynes, Drawing 6.

April, 19—

1. Clarence V. Dynes started business with cash \$5,000; merchandise \$10,000; real estate \$30,000; furniture and fixtures \$1,200.
5. Sold merchandise to L. D. Watterbury and Son, on account, \$6,000.
7. Sold merchandise to Henry J. Hyler for cash \$1,800.
9. Made his daughter a birthday gift of \$50 in cash.
10. Paid cash for taxes from April 15, 1919, to April 15, 1920, \$240.
12. Bought office supplies from J. L. Hervey, on account, \$165.
14. Bought the adjoining lot from Henry White giving a 30-day note in payment \$500.
17. Paid cash for salaries \$600.
18. Paid cash for salesman's traveling expenses \$50.
20. L. D. Watterbury returned merchandise of \$300 because it was not needed.
22. Bought merchandise from Gray and Crosby, on account, \$4,000.

24. Sold merchandise to Harley C. Gibbons for cash \$3,000.
26. Paid cash for miscellaneous expense \$125.
28. Donated \$25 to the United Charities.
30. Bought an adding machine from the Burroughs Adding Machine Company, on account, \$250.

(b) Enter totals and differences in small pencil figures, after which prepare a trial balance.

(c) On April 30 there was merchandise unsold of \$5,765. The following expense assets were consumed in operating the business: taxes \$20; office supplies \$65; salaries \$600; salesman's traveling expenses \$50; miscellaneous expense \$125; donations \$25.

(d) From the trial balance and inventory prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

12. (a) Record the following transactions in the ledger. Two sheets of ledger paper are required. Number the pages 1, 2, 3, 4. Arrange the accounts in the proper order and give each account the specified number of lines: Cash 12, Chester R. Tappan 5, Carl Friedman 3, Walter S. Scott 3, Merchandise Inventory 4, Merchandise Purchases 3, Merchandise Sales 7, Furniture and Fixtures 6, Delivery Equipment 3, Securities 3, Rent 3, Taxes 6, Expense 8, M. S. Grant 3, Notes Payable 3, Lewis L. Krammer, Capital 7, Merchandise Trading 8, Profit and Loss 7, Lewis L. Krammer, Drawing 5.

April, 19—

1. Lewis L. Krammer started business with cash of \$2,000; Merchandise \$3,500; furniture and fixtures \$800.
2. Paid cash for rent for April \$100.
3. Sold merchandise to Chester R. Tappan, on account, \$950.
5. Sold merchandise to Carl Friedman, on account, \$1,100.
6. Bought five \$50 Liberty bonds at \$47.50 each and paid for them in cash.
7. Withdrew cash for personal use \$45.
8. Bought a new cash register from the National Cash Register Company for \$110 cash.
10. Bought a horse and wagon from M. S. Grant, on account, \$450.
12. Paid cash for taxes to April of next year, \$48.
14. Sold merchandise to Walter S. Scott for cash \$1,200.

16. Bought merchandise from E. H. Stutie and Company for \$4,000, giving a 30-day note in payment.
18. Received check from Chester R. Tappan paying invoice of April 3, \$950.
20. Paid cash for clerks' salaries \$425.
22. Bought office supplies from L. C. Hayes for \$85 cash.
25. Paid cash for shipping supplies \$15.
30. Sold merchandise to Chester R. Tappan, on account, \$1,500.
Paid cash for personal coal bill \$64.

(b) Enter totals and differences in small pencil figures, after which prepare a trial balance.

(c) Merchandise inventory on April 30 was \$4,013. All expense assets were consumed in operating the business except \$44 of taxes.

(d) Prepare:

1. Balance sheet
2. Statement of profit and loss

(e) Close the ledger and prepare a post-closing trial balance.

CHAPTER XIII

THE JOURNAL

Purpose of Chapter.—

1. The function, form, and use of the journal.
2. Posting to the ledger.
3. Correction of errors.

How the Ledger Records a Transaction.—The ledger is valuable in that it sorts out and collects under suitable account titles all information which concerns each asset, liability, or capital item and shows the net effect of increases and decreases in each. This information is necessary in showing financial condition, but it does not serve all purposes.

Almost every transaction recorded in the books affects more than one account. Thus the purchase of merchandise for cash affects Merchandise Purchases, and Cash. Any one account, therefore, records only the part of the transaction affecting that particular account. The Cash account records the parts of many transactions which have increased or decreased cash, but the *complete* record of no transaction is found in the Cash account—only a partial record. We must look in other accounts for the rest of the record, and it may be widely scattered in different parts of the ledger—an inconvenient and unsatisfactory arrangement.

The Need for a Journal.—A business transaction is a unit, a complete happening, for which it is necessary to have available all the information. It does not suffice to know that on March 30 we sold \$100 worth of merchandise; we need to know the customers to whom it was sold. To know what else happened on

the 30th, every account in the ledger would have to be inspected, since it does not record in any one place or account all of the transactions occurring on a given date. It is very convenient to have: (1) in one place the full record of each transaction, and (2) a record of all transactions occurring on a given date in the order of their occurrence. Since the ledger does not give this in convenient form, it is necessary to provide another record known as a "journal." This will record all transactions just as they occur—one after the other in order of time, and is a chronological record, a history or diary of the changes in the assets, liabilities, and capital of a particular enterprise.

What to Record in the Journal.—The journal is not a book in which to record happenings different from and in addition to those in the ledger. It records the same transactions, but in a different form. Its form is that of a diary, whereas the ledger is a sorted record in accordance with the asset, liability, and capital titles affected. In your diary you would record, in the order of date, those events you considered as having a bearing on your life—as important enough to record. Likewise a ship's log contains a record of happenings which concern that particular ship. So, too, the newspaper records the history of the community, and in many places you will find it named *The Journal*. The minutes of a society, fraternal, or professional group constitute the history of that organization. Each records the events that are important to its members.

Since the *business enterprise* is concerned with events that affect its financial condition, *its journal* will contain a record of changes in assets, liabilities, and capital, because these are the facts that must be entered in the various accounts in the ledger. The journal then is a convenient device for gathering this information in chronological order. Transactions are entered *first*, as they take place, in the journal. For this reason it is called a book of *first* or *original* record. Then they are entered in the ledger. Since all transactions are to be transferred from the journal to the

ledger, the journal is a convenient place in which to indicate what accounts in the ledger will be affected by each transaction, thus simplifying their entry in the ledger.

Form and Arrangement of Material.—Any statement of the essential facts of transaction arranged chronologically constitutes a diary or journal. This may be simply a non-technical story or financial history of the business. Thus we may record some transactions of Martin Kellogg's rug and carpet business as follows:

January 2, 1920. Martin Kellogg began the wholesale rug and carpet business at 1279 State St., Chicago, Ill., investing \$50,000 in cash.

January 3. Bought for cash from the Boston Rug Company invoice of domestic rugs \$17,000.

January 5. F. S. Scott of Newark, Ohio, purchased from him rugs and carpets invoiced at \$4,000, on account, 30 days.

However, since certain parts of this story, from the standpoint of bookkeeping, are more important than others, years of experience have shown that the standard form of arrangement is more convenient than any other. For convenience the record is arranged as follows:

1. The date, consisting of month, day, year. This might appear at the left, or since a line is usually skipped to separate the transactions, it may be placed on the line above the description, effectually separating transactions. Usually the year and month appear only at the top of the page.
2. Statement of the debits and credits to be transferred to the ledger record.
3. What was done, bought, sold, paid, received, given, returned, etc. Usually the statement of the transaction will begin with one of these words.
4. With whom the transaction took place. The name of the individual, firm, or corporation.

5. Terms: on account, for cash, for note, etc.
6. Description of the things whose purchase, sale, or use brought about changes in assets, liabilities, or capital. Articles bought or sold, purpose for which money was received or paid, etc.

This or a similar arrangement makes for definiteness. When a standard form is used, comparison of each entry with this standard form affords a check on the omission of any essential element. The object in writing the description is to give all data necessary for a full understanding of what occurred, i.e., to present the information so clearly that not even anyone unfamiliar with the business can possibly mistake the meaning of the transaction.

Condense, tabulate, and abbreviate wherever possible, but never sacrifice clearness for brevity.

Indicating Debits and Credits.—Experience has shown that a uniform method of indicating in the journal the debits and credits of a transaction is advantageous. They might be written just above or below the description. In the standard form they are written in a position to make easy the transfer of the items to the ledger accounts affected. This is just above the description. Since the content of the transaction is well in mind when it is being arranged for recording, there is no practical difficulty in indicating the debits and credits first—in fact, it really aids in arranging the description.

How shall the debits and credits be indicated? The *form* is not all-important, but an arrangement in the most convenient *order* for transfer to the ledger accounts is advisable. Since the ledger shows debits on the left and credits on the right, that order will be followed in the journal. Since the names of the accounts debited and credited in each transaction are different, the amount of every debit and credit, as well as the name of the account affected, must be stated. This has led to the standard form of journal shown in Form 6 (a).

Explanation. The debit position is as far to the left as it can be written in the wide column. The credit position may be any distance to the right and one line lower than the debit position. The description is arranged in the form of a paragraph. We have indented the first line the same as the beginning of the credit position.

The other lines of the description extend all the way across the wide column from the rule at the left to the folio column at the right.

The unit-ruled money columns assist greatly in preventing errors in entering the amounts of money opposite the accounts debited and credited. See the journal on page 197.

CITY AND DATE

		Debit Amount							Credit Amount								
		Dollars			Cents				Dollars			Cents					
		F	H	T	T	H	T	U		H	T	T	T	U	T	U	
	Debit position	o	u	e	h	u	e	n		u	e	h	u	e	n	e	n
	Credit position	l	n	n	o	n	n	i		n	n	o	n	n	i	n	i
	Description of the trans-	i	d	u	d	s	t			d	u	d	s	t	s	t	
	action	o	r	t	s	r	s			r	t	s	r	s		s	
			e	h	a	e				e	h	a	e				
	Date	o	d	o	n	d				d	o	n	d				
		f		u	d	s					u	d	s				
			t	s	s					t	s	s					
		L	h	a						h	a						
		e	o	n						o	n						
		d	u	d						u	d						
		g	s	s						s	s						
		e	a							a							
		r	n	d						n	d						
			s							s							

Form 6. (a) Standard Form of Journal with Date Above the Debit and Credit Position

Other forms of the journal in general use are shown in Forms 6 (b), and 6 (c). Form 6 (b) is the same as Form 6 (a) except that the date is placed at the left of each transaction instead of above it and in the center of the page.

The Journal Record Illustrated.—We shall now show the operation of the journal by recording the transactions of Martin Kellogg. In the first entry in the journal the description often

Chicago, Illinois January 2, 19-- (Page 1)

[illegible]

January 4. 19-

(Page 2)

Modse Purchases.	5	12000	-
Philadelphia Carpet Co.	3		12000-
Bot of Phila Carpet Co. n/so.			
invoice of carpet \$12000			
5			
F. S. Scott	2	4000	-
Modse Sales	6		4000-
Sold to F. S. Scott n/so.			
invoice of rugs & carpets \$4000			

covers several pages, making it more convenient to set forth all the facts first and then indicate the debits and credits.

If there is not sufficient space at the end of a page to record all the data for a given transaction, it is considered better practice to record all of the transaction in question on the next page. The unused lines on the previous page may be canceled by ruling one or more lines across them.

Tabulating in the Journal.—If several items appear in the explanation of one journal entry, they are usually arranged in tabulated form. Assume that the items making up the invoice of goods sold to F. S. Scott were entered in full in the journal. Each item then begins a new paragraph as indicated below:

5			
F. S. Scott		4000	—
Merchandise Sales			4000
Sold to F. S. Scott, n/30:			
10 Oriental Rugs @ \$108 —	\$1,080		
20 Royal Wilton 9 × 12 @			
\$97 —	1,940		
490 yd. Axminster Carpet @			
\$2	980		
Total	\$4,000		

Reading the Journal.—It is customary in reading a journal entry to name the debit first and to insert the word “to” before naming the credit. If there is only one debit and one credit, it is customary to name the amount only once, after the credit. But if the entry consists of several debits and one or more credits, or vice versa, it is, of course, necessary to give the name and amount of every debit and every credit. Many accountants write the word “to” before the first credit item in every journal entry, although this is not considered necessary. The following journal entries will illustrate the foregoing:

March 10, 19—

Merchandise Purchases.....	\$3,000 —	
Cash.....		\$3,000 —

or

Merchandise Purchases.....	\$3,000 —	
To Cash.....		\$3,000 —

and

March 21, 19—

Cash.....	\$4,000 —	
Merchandise Inventory.....	6,000 —	
Furniture and Fixtures.....	1,000 —	
Notes Payable.....		\$3,000 —
John Davis, Capital.....		8,000 —

The second entry is read, March 21, 19—, Cash \$4,000; Merchandise Inventory \$6,000; Furniture and Fixtures \$1,000, to Notes Payable \$3,000; John Davis, Capital \$8,000.

Posting.—The first record of all transactions is made in the journal, as illustrated on page 197. After this, each debit and credit must be transferred to the ledger and sorted and collected by being recorded under its particular account title. This is a purely mechanical operation and consists merely in transferring from the journal to the proper accounts in the ledger the amounts placed opposite the accounts debited and credited in the journal. To illustrate the posting process we shall post from Martin Kellogg's journal to his ledger. Assume that the ledger accounts appear on the following pages: Cash on page 1; F. S. Scott, 2; Philadelphia Carpet Company, 3; Martin Kellogg, Capital, 4; Merchandise Purchases, 5; Merchandise Sales, 6. In posting place the journal to the left of the ledger on the desk, because almost all the writing will be done in the ledger. After transferring the journal record to the ledger, Kellogg's ledger will appear as follows:

3. The figure 1 is entered in the folio column just to the left of the money column, indicating the page of the journal from which this item came.

4. The letter "J," the initial of the book in which this item appears, is written to the left of the folio column. It is not placed in the folio column, because the journal page number frequently runs into three figures and fills the column.

5. The figure "2" is placed in the day-of-the-month column.

6. The month "Jan." is written in the month column.

7. The year "19—" is written just above the month.

This completes the record in the ledger. The explanation column may be used for additional information, but this is not essential because the full facts may be obtained from page 1 of the journal.

A final step is now necessary. Turn to the journal and observe that the figure 1 has been placed in the folio column to the right of Cash and just to the left of the \$50,000 in the debit money column. This indicates that the item has been transferred to the Cash account in the ledger. The initial of the ledger "L," is sometimes used but is not necessary because all debits and credits are transferred to the ledger. The initial of the book of original entry should be placed in the ledger, however, because several different kinds of journals are generally in use in business, and the initial indicates the particular journal from which the item came, as S for sales journal, P for purchase journal, etc., as the student will see later.

In the second account affected, that of Martin Kellogg, Capital, the procedure is as follows:

1. Turn to the Martin Kellogg, Capital account on page 4 in the ledger and observe that:

2. The amount of \$50,000 is entered in the *credit* money column.

3. The figure 1 is entered in the folio column.

4. The letter "J" to the left of the folio.

5. The day "2" in the day-of-the-month column.

6. The word "Jan." in the month column.

7. The year "19—" above the month.

This completes the record in the ledger. The next and last step is to turn to the journal and observe that the figure 4 has been placed in the folio column in the journal to the right of the credit item, Martin Kellogg, Capital and just to the left of the \$50,000 in the credit money column.

In like manner trace all the other debits and credits from the journal to the ledger, and you will understand the purpose and procedure of posting. Practice on the assignments will enable you to post accurately and rapidly. Strive for accuracy first, as speed without accuracy in posting is worthless.

Post Marking.—Entering a mark of some kind—the ledger page number as explained above—in the folio column in the journal opposite the debit or credit, to indicate that the item has been transferred to the ledger, is called **post marking**. The marks most generally used are the figure indicating the ledger page and the check mark (✓). The ledger page number is to be preferred because it affords convenient reference without using the ledger index. Sometimes both the ledger page number and the check mark (✓) are used. This is the case when the bookkeeper or his assistant first enters in the journal the ledger page opposite every debit and credit so that the ledger page can be found quickly when posting takes place. As each item is posted, a check mark (✓) is placed in the folio column in the journal. If the check mark (✓) or some other mark were not used, the one doing the posting would have difficulty in finding the place where he stopped if interrupted in his work. Also, care in marking just after posting prevents errors. All unmarked items should be investigated immediately.

Making Corrections.—It goes without saying that errors should not occur, but since they will occur, it is well to know how to correct them. In general, no erasures should be made in the journal or other book of original entry, because they may prevent the book from being used as evidence in court actions. They also

raise a doubt as to the ability of the worker and sometimes as to his honesty.

If a transaction has been omitted, all that is necessary is to enter it in the journal under the last transaction recorded, giving its proper date, and then to post it to the ledger. In posting, the correct date of the item may be entered in the account in the ledger or it may be posted as of the date of record and the correct date placed in the explanation column. This will call attention to the fact that the item is irregular.

If an error has been made in a journal entry in entering the name of an account or an amount of money, correction can be made by drawing a line through the incorrect item and writing the correct item just above it.

If an error is discovered after the ledger has been closed, a correcting journal entry will be necessary. If the correction involves an increase or decrease of capital, the proper credit or debit should first be made to the Profit and Loss account and then transferred to Capital. The reason for making the adjustment through Profit and Loss is to keep in one place in the ledger all changes in capital that have occurred during the current period.

Keep in mind that the proper corrections must be made in the accounts appearing in the post-closing trial balance as well as in the financial statements. If the correction entry does not involve change in capital, the Profit and Loss account is, of course, not used.

If, before closing, an item has been posted to the wrong side of an account or to the proper side of the wrong account, merely cross out the incorrect posting and post correctly.

If an item has been posted twice to the proper side of the correct account, cross out the second item posted.

Although other errors can be made, these will suffice to indicate the procedure to be followed in making corrections. An illustration follows, showing two methods used for correcting errors:

crossing out the incorrect items in the first journal entry and the account.

February 7, 19—

Notes Receivable.....	\$700 —
William Simpson.....	\$700 —

To correct the error made in the journal entry of 2/4/— on page — in which William Simpson's account was debited instead of Notes Receivable.

Posting the credit item to Simpson's account will correct the incorrect debit item, canceling his account, which will appear as follows:

WILLIAM SIMPSON

97 Main St., Oswego, N. Y.

19—					19—				
Feb.	4	J	3	700 —	Feb.	7	Error, Feb. 4	J	5
									700 —

Advantages of the Journal.—The chief advantages of using both a journal and a ledger instead of just a ledger may be summed up as follows:

1. Shows in convenient chronological order the record of events affecting assets, liabilities, and capital.
2. Relieves the ledger of a mass of information, making that book merely a summary of debits and credits.
3. Affords an easy means of reference to any transaction in its entirety and to all happenings on a given date.
4. Renders less likely the error of entering only a part of the debits and credits in the ledger, as might occur were one interrupted before completing the entry of a transaction.
5. Transferring of debits and credits from the journal to the ledger may be done as time permits, or may be assigned to an assistant.

The only disadvantage is that additional time is required to write the record in one book and then transfer part of the information to another book. However, the advantages set forth more than outweigh this one disadvantage.

QUESTIONS

1. Why is a journal necessary?
2. (a) What name is given to a personal journal? A ship's journal? The journal of a community? The journal of a professional or social society?
- (b) What will each of the above journals contain?
3. What is recorded in a business journal?
4. Name and explain five (5) items that should appear in the description of a transaction.
5. What is a convenient arrangement of the items in Question 4?
6. In writing the description of a transaction, should clearness be sacrificed for brevity? Why?
7. What is the preliminary statement or introduction in a journal? What other names are given to it?
8. What is the most convenient way to indicate debits and credits in a journal? Why?
9. What is the ruling for a standard form of journal? Illustrate.
10. Show how the position of the ledger folio column may vary in the standard journal.
11. (a) Give as many different forms of journal as you can. Obtain some from business men or think them out yourself.
- (b) In what respect are they similar?
12. Where should the debit position begin? Credit position?
13. Where would you begin the first line of the description? Why?
14. How is a tabulated description recorded in the journal? Illustrate.
15. How should a journal entry be read: (a) If it contains one debit and one credit? (b) If it contains several debits or credits?
16. Is it necessary to use the word "to" before the credit item? Why?
17. Give five advantages in using a journal. Can you give any other advantages?
18. Give any disadvantages arising from the use of a journal.
19. (a) What is meant by "posting"? (b) Give the best procedure.
20. Why is it necessary to write the letter "J" in the ledger opposite every item posted from the journal?

21. Why is it necessary to post mark items in the journal?
22. Is it necessary to use the letter "L" in post marking items in the journal? Why?
23. Why should erasures not be made in a book of original entry?
24. How may an error in the journal be corrected: (a) Before posting?
(b) After posting?
25. Indicate the procedure to be followed in correcting an error discovered after closing the ledger.

PROBLEMS

1. (a) Rule each side of a sheet of letter-size paper about $8 \times 10\frac{1}{2}$ inches, in the standard journal form. Turn the paper over to the left, as if it were a page in a book, when preparing to rule the second page.

(b) Number the sheet, pages 1 and 2. The odd numbered pages 1, 3, 5, etc., should have the page number in the upper right corner; the even numbered pages 2, 4, 6, etc., should have the page number in the upper left corner.

(c) Record the following transactions in the journal.

(d) After this journal has been corrected in class or otherwise, it will serve as the basis for an assignment in posting; therefore you should keep the paper in good condition. If your journal is not neat, rewrite it.

June, 19—

1. James Marshall began the wholesale hay and feed business at 62 Seventh Ave., Detroit, Mich., with a cash investment of \$15,000.
2. Paid Howard and Gibbs by check \$400 for rent of premises for June and July. Bought for cash bill of hay and feed from the Western Grain Company, 14 Division St., Chicago, Ill. Total \$6,000.
5. Sold for cash to John Drew invoice of hay \$4,300.
9. Sold 20 tons feed at \$97.50 per ton to Hiram McCormick, 90 Southern Ave., City, terms cash in 10 days.
12. Bought 40 tons feed at \$75, 30 tons timothy hay at \$32, 10 tons alfalfa at \$30, from Union Grain Company, 316 La Fayette St., St. Louis, Mo., terms on account.
17. Sold 5 tons feed at \$102, 10 tons alfalfa at \$40, to Central Hay and Feed Company, Jackson, Mich., terms on account.

2. (a) Rule both sides of a sheet of paper in journal form and number the pages 1 and 2.

(b) Journalize the following (keep this journal until called for):

March, 19—

1. Arthur Farwell began the wholesale furniture business at 75 Magnolia Ave., Richmond, Va. His assets consisted of cash \$9,000; office and store fixtures \$1,500; stock of furniture \$40,000; and office supplies \$200.
5. Paid cash to Southern Realty Company for rent of store for 3 months from March 1, \$750.
16. Bought invoice of furniture \$7,000 from Dixie Furniture Company, Staunton, Va., terms, \$3,000 in cash and his note at 45 days without interest for the balance.
29. Paid clerks' salaries in cash \$100.

April, 19—

6. Sold invoice of furniture \$4,000 to Robson and Bell, 85 Greene Ave., Atlanta, Ga., for their 30-day note without interest.
20. Sold \$3,000 bill of furniture to the Williams Furniture Company, Knoxville, Tenn., for cash.
30. Paid cash \$4,000 for his 45-day note of 3/16/— favor of Dixie Furniture Company.

3. (a) Rule both sides of a sheet of paper in journal form and number the pages 1 and 2.

(b) Journalize the following (keep this journal until called for):

March, 19—

1. Joseph Fay began the flour and grain business at 2715 Oak St., Cincinnati, Ohio, by investing cash \$8,000.
2. Bought from William Dempsey for cash, 100 bbl. flour at \$10 per bbl., \$1,000.
3. Bought from Frank Carter, 152 Main St., on account, 200 bu. wheat at \$2 per bu., \$400.
4. Paid rent of store for March \$150 to J. L. Howe.
6. Sold to Alexander Lord, Circleville, Ohio, on account, 40 bbl. flour at \$13 per bbl., \$520.
10. Cash sales \$450.
15. Paid Harry Smith, bookkeeper, salary of \$20 cash.

4. Problem 4 is a continuation of Joseph Fay's business. Use the same journal and enter the following transactions:

March, 19—

17. Alexander Lord returned 5 bbl. flour as unsatisfactory \$65
19. Paid clerk hire \$25 cash.

21. Sold to Henry Miller for cash 75 bu. wheat at \$2.50 per bu., \$187.50.
 23. Paid for repairs to store \$10 cash.
 26. Paid invoice of 3d of Frank Carter in cash \$400.
 28. Bought from Jacob Frank, Dayton, Ohio, on 30-day note, 100 bbl. flour at \$10.35 per bbl., \$1,035.00.
 31. Proprietor took \$200 cash for private use.
5. (a) Rule paper in journal form and number pages 1 and 2.
(b) Journalize the following (keep this journal until called for):

August, 19—

1. David Foster began the ribbon and lace business with cash \$5,000; owing to Thomas Blake, on account, \$150; due from Abraham Conklin, on account, \$200.
2. Paid rent of building for August and September, \$300 cash to Close Realty Company.
7. Bought of James Cooper, on account, 500 yd. No. 2 ribbon at 10 cents and 600 yd. No. 5 lace at 12 cents.
10. Bought of Thomas Blake 1000 yd. No. 4 ribbon at 20 cents. Paid cash \$100; balance on his, Foster's, 30-day note without interest.
17. Sold to Herman Singer, on account, 100 yd. No. 2 ribbon at 15 cents.
20. Bought merchandise for cash \$3,000.
29. Paid clerks' salaries \$25 cash.
30. Sold merchandise for cash \$1,000.
31. Returned to James Cooper 100 yd. No. 2 ribbon at 10 cents as not being the color ordered. Proprietor drew for personal use merchandise \$10.

6. This is a continuation of David Foster's business. Use the same journal with another sheet numbered 3 and 4 and enter the following transactions:

September, 19—

2. Paid for store fixtures \$50 cash.
7. Sold Henry Davis, on account, 200 yd. No. 5 lace at 18 cents.
9. Bought 200 2-cent postage stamps.
10. Paid note due Thomas Blake today \$100.
18. Received check from Abraham Conklin paying account open August 1, \$200.
23. Sold merchandise for cash \$1,500.

- 25. Paid James Cooper \$50 on account of bill of August 7.
- 30. Paid delivery boy's salary \$6 cash.

7. (a) Write the following accounts on a sheet of standard ledger paper, allowing the indicated number of lines for each account (be sure to arrange accounts in proper order): Cash 5, Rent 3, Merchandise Purchases 3, Merchandise Sales 4, Hiram McCormick 2, Union Grain Company 2, Central Hay and Feed Company 2, James Marshall, Capital 3.

(b) Post the debits and credits from the journal used in Problem 1 in this chapter to the accounts in this new ledger. Be sure that you post mark correctly.

(c) On a separate sheet of journal-ruled paper prepare a trial balance of differences from your ledger.

8. (a) On a sheet of ledger paper open the necessary accounts. One sheet of ledger paper is required. Number the pages 1 and 2. Allow 8 lines for Cash account, 3 lines for each of the other accounts.

(b) Post the items from your journal of Problem 2.

(c) Take a trial balance.

9. (a) One sheet of ledger paper is required. Number the pages 1 and 2. Open accounts allowing 11 lines for Cash, 6 for Merchandise Sales, 5 each for Merchandise Purchases and Expense, 4 each for Alexander Lord and Joseph Fay, Capital, 3 each for Frank Carter and Rent.

(b) Post from your journal of Problem 3 and take a trial balance.

10. This is a continuation of Problem 9.

(a) Open an additional account with Notes Payable allowing 3 lines for it on the Problem 9 ledger.

(b) Post from the journal of Problem 4.

(c) Take a trial balance.

11. (a) One sheet of ledger paper is required. Number the pages 1, 2. Open accounts in the ledger and allow number of lines as follows: Cash 12; Merchandise Purchases and Merchandise Sales 4 each, Expense and James Cooper 5 each, 3 each for the other accounts.

(b) Post from journal of Problem 5.

(c) Take trial balance.

12. This is a continuation of Problem 11.

(a) Open additional accounts with Henry Davis and Furniture and Fixtures on the ledger for Problem 11 and allow 3 lines for each.

(b) Post from journal of Problem 6.

(c) Take a trial balance.

CHAPTER XIV

LEDGER CLOSING BY MEANS OF THE JOURNAL

Purpose of Chapter.—

1. The accounting cycle.
2. Adjusting and closing journal entries.
3. Balancing an account.

The Accounting Cycle.—The use of a comparative balance sheet to show assets, liabilities, and capital at the beginning of a period and at the end of the period, and to indicate the changes which have taken place, has been explained in Chapter VII. It has been shown how the ledger collects all changes in assets, liabilities, and capital, from the beginning to the end of the period, and how it is necessary to clear every account of all changes in capital that have occurred during the current period by transfer to the Capital account via the Trading and Profit and Loss and Drawing accounts, in order to mark the end of one period and prepare the ledger to perform its function as a device for collecting changes in assets, liabilities, and capital for the next period.

In other words, at the beginning of any period, the accounts in the ledger show the exact condition of all the assets, liabilities, and capital; that is, the balance sheet and the ledger show the same financial condition. The ledger, however, has the items arranged in convenient form to show increases and decreases.

The time intervening between the beginning and ending dates is the **accounting cycle**, the **accounting period**, or the **fiscal period**, and may be of any length. The usual practice is to close the

books once each year. However, many businesses close more frequently—some every 6 months; some every 4 months; others every 3 months; and still others every calendar month, with a summary for the 12 months comprising the year. If the books are closed December 31 for the year, the accounting or fiscal period is the same as the calendar year. The 4-week period has been adopted by many concerns. This has the advantage of making every one of the 13 periods in the year (52 weeks) of equal length. The usual summary of the 13 periods would give the desired information for the fiscal or for the calendar year.

Adjustments.—Before the fiscal record of one period can be closed all information relating to that period must be recorded on the books. The entries to record, at the close of the period, all items not recorded in the regular course of the bookkeeping routine are called “adjustment” entries. These comprise such items as claims against others for rent, interest, etc., owed by them but not yet due because the payment date falls in the next fiscal period. The portion belonging to the current period, because earned during this period, should be recorded before closing the books. So, also, items owed to others for services received but not yet paid for must be recorded. Where clerks are paid at the end of each week and the fiscal period ends at the middle of the week, the salaries earned by them up to that time are liabilities which must be recorded, in order to show the total amount of services for the current period, even though payment for them will not be made till the next period. These adjustment entries will be further explained in Chapter XV in connection with accruals.

After making all adjustment entries, the next step is to transfer increases and decreases in capital to the Capital account. These latter are really the closing entries, but in many cases the adjusting and transferring entries together are termed “closing” entries, because the adjusting entries are usually made at the

time of closing the ledger. The advantages of chronological order and full description apply to all records made on the books. Therefore, to secure these advantages, all entries, including adjusting and closing entries, must first be made in the journal. It is just as convenient to indicate the debits and credits and write the necessary descriptions or explanations for the adjusting and closing entries in the journal, as it is to record the information for other transactions in this book. The journal also enables one to record them in a comparatively small space where they are available for easy reference.

The Closing Entries.—Closing entries, as distinguished from adjustment entries, consist merely in making transfers of increases and decreases in capital from the various accounts to the Capital account by way of the Trading and the Profit and Loss accounts.

To illustrate closing the ledger by means of entries in the journal, we shall show the condition of the business of Thomas Lipton after operating during the month of March, 19—. The trial balance shows the condition of the ledger before closing March 31, 19—. From the trial balance and the additional information, the present financial condition of Lipton's business is shown by its balance sheet and the sources of changes in capital are exhibited by means of the statement of profit and loss. Following these are given the closing journal entries which indicate the transfers to be made in the ledger. There is next shown the ledger after closing, containing all the information found in the trial balance, additional information, statement of profit and loss, and the balance sheet.

It is best to study the balance sheet and statement of profit and loss in connection with the trial balance and additional information until the problem is fully understood, and then to trace the closing journal entries from the journal to the ledger. The entries are readily identified by the numbers in parentheses, (1) to (8) at the left of each entry and in the explanation column

of each account affected in the ledger. These parenthetical numbers are not any part of the bookkeeping record but are inserted to aid the student in tracing the entries. Read carefully the explanation for each entry and try to get a good mental picture of the effect of the entry after it has been posted. The statement of profit and loss is of great assistance in understanding the closing journal entries, since they carry out the operations performed in that statement. For example, the total cost of merchandise available for sale, \$13,000, obtained in the statement by adding the *purchases* and the *initial inventory* is carried out in the ledger by means of the following entries:

- (1) Merchandise Trading..... \$4,000 -
 Merchandise Inventory..... \$4,000 -
- (2) Merchandise Trading..... 9,000 -
 Merchandise Purchases..... 9,000 -

and the cost of goods sold, found in the statement by subtracting the *final inventory* from the *total cost of goods available for sale*, is effected in the ledger through the journal entry:

- (3) Merchandise Inventory..... \$2,000 -
 Merchandise Trading..... \$2,000 -

THOMAS LIPTON, TRIAL BALANCE, MARCH 31, 19—

1	Cash.....	\$ 2,100 -	
1	Adna Weber	300 -	
1	Merchandise Inventory	4,000 -	
1	Furniture and Fixtures	1,000 -	
1	Peter Peterson		\$ 1,000 -
2	Thomas Lipton, Capital		2,360 -
2	Thomas Lipton, Drawing.....	100 -	
3	Merchandise Purchases.....	9,000 -	
3	Merchandise Sales.....		14,000 -
3	Expense	300 -	
3	Rent	400 -	
3	Salaries	160 -	
		<u>\$ 17,360 -</u>	<u>\$ 17,360 -</u>

Additional information obtained from various sources on
March 31, 19—

Merchandise inventory.....	\$2,000 —
Expense inventory.....	100 —
Rent inventory.....	200 —
Furniture and fixtures depreciated.....	2 ⁰⁰ / ₁₀₀

Do not commit to memory the explanation for the journal entries. Learn to write the proper explanation by understanding the effect of each entry. Notice that every explanation states what was done, and why.

THOMAS LIPTON

BALANCE SHEET

March 31, 19—

Assets:		
Cash.....	\$2,100 —	
Accounts Receivable.....	300 —	
Merchandise Inventory 3/31/—.....	2,000 —	
Expense Unconsumed.....	100 —	
Rent Prepaid.....	200 —	
Furniture and Fixtures.....	980 —	
Total.....		\$5,680 —
Liabilities:		
Accounts Payable.....	\$1,000 —	
Total.....		1,000 —
Capital:		
Original Investment.....	\$2,360 —	
Net Profit.....	\$2,420	
Less: Withdrawal.....	100	
Net Increase in Investment.....	2,320 —	
Total.....		\$4,680 —

THOMAS LIPTON

STATEMENT OF PROFIT AND LOSS

From March 1 to 31, 19—

Sales.....		\$14,000	—
Cost of Goods Sold:			
Purchases.....	\$ 9,000	—	
Add Inventory 3/1/—.....	4,000	—	
Total cost of merchandise.....	\$13,000		
Less: Inventory 3/31/—.....	2,000		
Cost of goods sold.....		11,000	—
Gross Profit on Sales.....		\$ 3,000	—
Operating Expenses:			
Expense.....	\$ 200	—	
Rent.....	200	—	
Salaries.....	160	—	
Furniture and Fixtures Depreciation.....	20	—	
Total.....		580	—
Net Profit.....		\$ 2,420	—

CLOSING JOURNAL ENTRIES

March 31, 19—

(Page 18)

(1)	Merchandise Trading	2	4,000	—		
	Merchandise Inventory	1			4,000	—
	To transfer the amount of goods on hand (Merchandise Inventory) March 1, 19—, to Trading account to find the total cost of goods available for sale.					
(2)	Merchandise Trading	2	9,000	—		
	Merchandise Purchases	3			9,000	—
	To transfer the amount of goods purchased during the month to Trading account to find the total cost of goods available for sale.					

(3)	Merchandise Inventory	1	2,000	-	
	Merchandise Trading	2			2,000 -
	To deduct the present inventory (cost of goods unsold) from the total cost of goods to find the cost of goods sold and to show the amount of goods unsold (final inventory).				
					(Page 19)
(4)	Merchandise Sales	3	14,000	-	
	Merchandise Trading	2			14,000 -
	To transfer the amount of sales to Trading account to find the gross profit on sales.				
(5)	Merchandise Trading	2	3,000	-	
	Profit and Loss	2			3,000 -
	To transfer the gross profit on sales to the Profit and Loss account.				
(6)	Profit and Loss	2	580	-	
	Expense	3			200 -
	Rent	3			200 -
	Salaries	3			160 -
	Furniture and Fixtures	1			20 -
	To transfer from the above accounts to Profit and Loss account the amount of the several items consumed in operating the business, for the purpose of finding the net increase in capital (net profit).				
					(Page 20)
(7)	Profit and Loss	2	2,420	-	
	Thomas Lipton, Drawing	2			2,420 -
	To transfer the net profit to the Drawing account to find the profit remaining in the business.				
(8)	Thomas Lipton, Drawing	2	2,320	-	
	Thomas Lipton, Capital	2			2,320 -
	To transfer the net increase in capital to the Capital account to find the present invested capital.				

Balancing an Account.—The proprietor's capital account might be closed by making a journal entry as below:

Thomas Lipton, Capital (old).....	\$4,680 -
Thomas Lipton, Capital (new).....	\$4,680 -

After posting the debit item the old account would be totaled and ruled off, and then the credit item would be posted. This would carry out the scheme of writing journal entries for every item in the ledger, and could be applied to every other account having an excess on the debit or credit side—such as Cash, Notes Receivable, Notes Payable, Real Estate, Mortgage Payable, etc. In practice this is not necessary, because all the facts in regard to the account remain in the account—are not transferred to some other account. Therefore the date, the word “balance,” and the amount of the excess of the larger over the smaller side, are entered directly on the smaller side of the account without making a journal entry. The account is then totaled, ruled off, and the same information entered below the ruling on the larger side to indicate the present condition of the account. This is called **balancing an account**. Even this balancing is often omitted, because the difference between the debits and credits indicates an asset, if the debit side is larger, and a liability, or capital, if the credit side is larger, and may be shown in pencil figures just as is done before taking a trial balance. Usually the accounts affecting Trading and Profit and Loss are the only ones balanced.

CASH				(Page 1)			
19—							
Mar.	1	J	2,100 -				
	to						
	31						
				ADNA WEBER			
19—							
Mar.	1	J	300 -				
	to						
	31						

MERCHANDISE INVENTORY

(Page 1)

19— Mar. 1	J	4,000 —	19— Mar. 31	Trading (1) J 18	4,000 —
Mar. 31	Trading (3) J 18	2,000 —			
		FURNITURE AND FIXTURES			(Page 1)
19— Mar. 1	J	1,000 —	19— Mar. 31	P. & L. (6) J 19	20 —
		PETER PETERSON			
			19— Mar. 1	J	1,000 —
			to 31		
		THOMAS LIPTON, CAPITAL			(Page 2)
19— Mar. 31	Balance	4,680 —	19— Mar. 1	J	2,360 —
			31	D/a (8) J 20	2,320 —
		4,680 —			4,680 —
			Mar. 31	Balance	4,680 —
		THOMAS LIPTON, DRAWING			
19— Mar. 1	J	100 —	19— Mar. 31	P. & L. (7) J 20	2,420 —
31	C/a (8) J 20	2,320 —			
		2,420 —			2,420 —
		PROFIT AND LOSS			(Page 2)
19— Mar. 31	Expense (6) J 19	200 —	19— Mar. 31	Sales (5) J 19	3,000 —
31	Rent (6) J 19	200 —			
31	Salaries (6) J 19	160 —			
31	Furn. & Fix. (6) J 19	20 —			
31	Draw a/c (Net Profit) (7) J 20	2,420 —			
		3,000 —			3,000 —

MERCHANDISE TRADING

(Page 2)

19— Mar. 31	Invty. (1) J 18	4,000 —	19— Mar. 31	Invty. (3) J 18	2,000 —
31	Pur. (2) J 18	9,000 —	31	C o s t o f Goods Sold	11,000 —
		13,000 —			13,000 —
19— Mar. 31	C o s t o f Goods Sold	11,000 —	19— Mar. 31	Sales (4) J 19	14,000 —
31	P. & L. (5) J 19	3,000 —			14,000 —
		14,000 —			
MERCHANDISE PURCHASES (Page 3)					
19— Mar. 1 to 31	J	9,000 —	19— Mar. 31	Trading (2) J 18	9,000 —
MERCHANDISE SALES					
19— Mar. 31	Trading (4) J 19	14,000 —	19— Mar. 1 to 31	J	14,000 —
EXPENSE					
19— Mar. 1 to 31	J	300 —	19— Mar. 31	P. & L. (6) J 19	200 —
RENT					
19— Mar. 1 to 31	J	400 —	19— Mar. 31	P. & L. (6) J 19	200 —
SALARIES					
19— Mar. 1 to 31	J	160 —	19— Mar. 31	P. & L. (6) J 19	160 —

POST-CLOSING TRIAL BALANCE, MARCH 31, 19—

1	Cash.....	\$2,100	—		
1	Adna Weber.....	300	—		
1	Merchandise Inventory.....	2,000	—		
1	Furniture and Fixtures.....	980	—		
1	Peter Peterson.....			\$1,000	—
2	Thomas Lipton, Capital.....			4,680	—
3	Expense.....	100	—		
3	Rent.....	200	—		
		\$5,680	—	\$5,680	—

QUESTIONS

1. If two balance sheets are prepared for a business enterprise, one at the beginning and the other at the end of a definite period of time, what information will be furnished?
2. What function does the ledger perform?
3. What transfers must be made in the ledger to enable it to perform this function properly?
4. Through what accounts are these transfers made?
5. (a) What is "an accounting cycle"?
- (b) What is the length of such a cycle?
6. (a) What is a calendar period?
- (b) What is a fiscal period?
7. What advantage is claimed for the 4-week period?
8. (a) What are adjusting entries?
- (b) What are closing entries?
9. What are the advantages of closing the ledger by means of journal entries?
10. In what way can the statement of profit and loss be of assistance in writing the closing journal entries?
11. What two things should the explanation of a closing journal entry contain?
12. Explain each of the 8 closing journal entries made to close Lipton's ledger.
13. How may an account be balanced?
14. Why is Thomas Lipton's Capital account balanced?
15. How could Lipton's Capital account be balanced by journal entry?

PROBLEMS

Some of the following assignments are based on the ledgers and trial balances you prepared in Chapter XIII. In solving these problems open Merchandise Trading, and Profit and Loss accounts in the ledger you used in the Chapter XIII work, and then close the ledger by means of journal entries. Use separate sheets of journal-ruled paper for the closing entries and number the pages, beginning with the next consecutive number following the old journal used in your solution for the Chapter XIII problems.

1. From the following trial balance and additional information for Problem 7, Chapter XIII—

- (a) Prepare balance sheet as of June 24, 19—.
- (b) Prepare statement of profit and loss for 24 days.
- (c) Write the closing journal entries, post, and close the ledger.
- (d) Prepare post-closing trial balance.

JAMES MARSHALL, TRIAL BALANCE, JUNE 24, 19—

Cash.....	\$12,900	—		
Hiram McCormick.....	1,950	—		
Central Hay and Feed Company.....	910	—		
Union Grain Company.....			\$ 4,260	—
James Marshall, Capital.....			15,000	—
Merchandise Purchases.....	10,260	—		
Merchandise Sales.....			7,160	—
Rent.....	400	—		
	\$26,420	—	\$26,420	—

Assume that the following additional information is available for Problem 1, Chapter XIII: June 24, 19—, merchandise inventory \$4,000; rent prepaid from June 24 to July 31, \$100.

2. From the following trial balance and additional information for Problem 8, Chapter XIII—

- (a) Prepare balance sheet as of April 30, 19—.
- (b) Prepare statement of profit and loss for 2 months.
- (c) Write the closing journal entries, post, and close the ledger.
- (d) Prepare a post-closing trial balance.

ARTHUR FARWELL, TRIAL BALANCE, APRIL 30, 19—

Cash.....	\$ 4,150	—		
Notes Receivable.....	4,000	—		
Merchandise Inventory.....	40,000	—		
Furniture and Fixtures.....	1,500	—		
Arthur Farwell, Capital.....			\$50,700	—
Merchandise Purchases.....	7,000	—		
Merchandise Sales.....			7,000	—
Office Supplies.....	200	—		
Expense.....	100	—		
Rent.....	750	—		
	\$57,700	—	\$57,700	—

Additional information: April 30, 19—, merchandise inventory \$44,000; rent prepaid 1 month \$250; office supplies unconsumed \$150; office and store fixtures depreciated 4%.

3. From the following trial balance and additional information prepare:

- Balance sheet as of March 15, 19—.
- Statement of profit and loss from March 1 to March 15.
- The closing journal entries.

GEORGE WHITAKER, TRIAL BALANCE, MARCH 15, 19—

Cash.....	\$ 7,130	—		
J. C. Woods.....	520	—		
Frank Poulter.....			\$ 400	—
George Whitaker, Capital.....			8,000	—
George Whitaker, Drawing.....	150	—		
Merchandise Purchases.....	1,400	—		
Merchandise Sales.....			970	—
Rent.....	150	—		
Expense.....	20	—		
	\$9,370	—	\$9,370	—

Additional information: merchandise inventory \$810; rent prepaid one-half month \$75; expense all consumed.

4. From the following trial balance and additional information for Problem 10, Chapter XIII—

- Prepare balance sheet as of March 31, 19—.
- Prepare statement of profit and loss for the month of March, 19—.
- Write closing journal entries, post, and close the ledger.
- Prepare a post-closing trial balance.

JOSEPH FAY, TRIAL BALANCE, MARCH 31, 19—

Cash.....	\$ 6,832	50		
Alexander Lord.....	455	—		
Notes Payable.....			\$ 1,035	—
Joseph Fay, Capital.....			8,000	—
Joseph Fay, Drawing.....	200	—		
Merchandise Purchases.....	2,435	—		
Merchandise Sales.....			1,092	50
Expense.....	55	—		
Rent.....	150	—		
	\$10,127	50	\$10,127	50

Additional information: merchandise inventory \$1,845; expense inventory \$15; rent all consumed.

5. From the following trial balance and additional information prepare:

- Balance sheet as of August 31, 19—.
- Statement of profit and loss for month of August.
- Closing journal entries.

JOHN UNDERWOOD, TRIAL BALANCE, AUGUST 31, 19—

Cash.....	\$4,575	—		
Richard Neel.....	200	—		
L. C. Conner.....	15	—		
Notes Payable.....			\$ 100	—
Thomas Krinhop.....			150	—
James Levison.....			112	—
John Underwood, Capital.....			5,150	—
John Underwood, Drawing.....	100	—		

Merchandise Purchases.....	312	-		
Merchandise Sales.....			15	-
Rent.....	300	-		
Expense.....	25	-		
	<u>\$5,527</u>	-	<u>\$5,527</u>	-

Additional information: merchandise inventory \$302; rent prepaid 1 month \$150; expense inventory \$10.

6. From the subjoined trial balance and additional information for Problem 12, Chapter XIII—

- Prepare balance sheet as of September 30, 19—.
- Prepare statement of profit and loss for September.
- Write the closing journal entries, post, close the ledger.
- Prepare the post-closing trial balance.

DAVID FOSTER, TRIAL BALANCE, SEPTEMBER 30, 19—

Cash.....	\$4,065	-		
Herman Singer.....	15	-		
Henry Davis.....	36	-		
Furniture and Fixtures.....	50	-		
Thomas Blake.....			\$ 150	-
James Cooper.....			62	-
David Foster, Capital.....			5,050	-
David Foster, Drawing.....	10	-		
Merchandise Purchases.....	3,312	-		
Merchandise Sales.....			2,561	-
Rent.....	300	-		
Expense.....	35	-		
	<u>\$7,823</u>	-	<u>\$7,823</u>	-

Additional information: merchandise inventory \$978; expense items and rent consumed; furniture and fixtures depreciated 3%.

7.

JAMES C. HAY, TRIAL BALANCE, APRIL 30, 19—

Cash.....	\$ 8,713	44		
Max Goldsmith.....	600	-		
Marlowe and Brothers.....	249	-		
Fargo, Smith and Company.....	483	-		

Merchandise Inventory.....	1,000	—		
Machinery.....	500	—		
Notes Payable.....			\$ 1,000	—
Thomas Morline.....			401	44
John Cross.....			1,200	—
James C. Hay, Capital.....			10,400	—
James C. Hay, Drawing.....	200	—		
Merchandise Purchases.....	1,272	—		
Merchandise Sales.....			966	—
Rent.....	750	—		
Expense.....	200	—		
	<u>\$13,967</u>	<u>44</u>	<u>\$13,967</u>	<u>44</u>

Additional information: merchandise inventory \$800; rent prepaid 2 months \$500; expense inventory \$60; machinery depreciated 1%.

From the above trial balance and additional information prepare:

- Balance sheet as of April 30, 19—.
- Statement of profit and loss for April.
- The closing journal entries.

8.

GEORGE DUNN, TRIAL BALANCE, MAY 31, 19—

Cash.....	\$ 7,252	64		
Jamison and Brothers.....	249	—		
Grey and Young.....	483	—		
Barrett and Company.....	963	—		
Merchandise Inventory.....	1,000	—		
Machinery.....	500	—		
Furniture and Fixtures.....	210	—		
Thomas Osterman.....			\$ 200	—
Standard Machine Company.....			50	64
George Dunn, Capital.....			10,400	—
George Dunn, Drawing.....			150	—
Merchandise Purchases.....	1,082	—		
Merchandise Sales.....			1,929	—
Rent.....	750	—		
Expense.....	240	—		
	<u>\$12,729</u>	<u>64</u>	<u>\$12,729</u>	<u>64</u>

Additional information: merchandise inventory \$600; rent prepaid 1 month \$250; expense consumed \$150; machinery depreciated 2%; furniture and fixtures depreciated 3%.

From the above trial balance and the additional information prepare:

- (a) Balance sheet as of May 31, 19—.
- (b) Statement of profit and loss for April and May.
- (c) Closing journal entries.

CHAPTER XV

ACCRUALS

Purpose of Chapter.—

1. Nature of accrued liabilities and assets.
2. Methods of recording them.

Paying Wages, Salaries, Rent, and Interest.—In many business transactions, trade or business custom plays an important part. This is particularly true of the matter of paying wages, rents, etc. In a few cases the laborer is paid his wage at the end of each day's work. More often, however, payment is made once a week—sometimes upon completion of the week's work, often not until two or three days afterward, the additional days being needed where large numbers of men are employed to make up the pay-roll, fill each man's envelope with the amount of his wages, etc. Where irregular work periods involving overtime calculations occur, it is not possible to know the exact amount of each workman's wages at the close of the week. With some classes of employees, payment is made twice a month; with others, once a month; and with others, the custom is for them to draw money as needed against salary or commissions, with a settlement of the balance due once a year. Therefore, at the close of each day, unless payment is made daily, the business owes the workman or employee for the services rendered, though in accordance with custom, this wage may not be due.

In the case of rent payments, custom also governs. In some places rents must be paid in advance; in others, not until the end of the period of occupancy. In the case of borrowed money, in many instances the charge for its use becomes due and payable at

the *end* of the period of use. In other instances it must be paid at the *beginning* of the period.

Recording Expense Purchases.—In all cases, however—unless payment is made before any use or service is received—at the end of each day's use the liabilities of the business have increased by the amount of the unpaid charges. It is not customary to record these each day because information about them is not needed daily, but it is the almost universal practice to make a record only at the time the services are paid for. The books will then show only the debit to the particular expense purchase account and the credit to Cash, the liability not being recorded because now settled.

Accrued Liabilities.—The dates for paying such items are a result of accident, custom, or convenience. At the close of a fiscal period when it becomes necessary to determine accurately all liabilities, account must be taken of both those which have and those which have not been recorded. It seldom, or never, happens that the customary dates for paying these items exactly coincide with the end of the fiscal year. Hence many are unpaid and must, for the sake of accurately stating *all* liabilities, be recorded. Liabilities which have been accumulating day by day, which have not been recorded on the books, are called **accrued liabilities**. Depending on custom, they may or may not be due. Examples are amounts owed for wages, salaries, taxes, rent, commission, etc.

Recording Accrued Liabilities.—At the time of preparing the balance sheet and of closing the ledger, the amounts of these items that have accumulated must be added to the liabilities if the correct amount of debts is to be stated. It is understood that the expense purchase in the form of wages, salaries, etc., has been received but no record of the fact has been made. Instead of classing all expense purchases as services, some speak of wages

and salaries as services; taxes and insurance as protection; and rent as the right to the use of a building, money, or an automobile, etc. Rent of money is referred to as **interest**, rent of an automobile as **hire** or **fare**.

To illustrate how to record accrued liabilities the following problem will be solved:

Problem. It is June 30 and you owe your clerk, Tom Harper, 10 days' salary at the rate of \$30 per week, i.e., \$5 per day. It is customary to pay every 2 weeks, therefore payment will be made on July 4 or 5.

It is evident that the expense purchase represented by the services performed by Tom Harper amounts to \$50, and that your liability to him for services has increased by the same amount.

In general terms, the journal entry to indicate unpaid expense purchases might read:

June 30	
Debit some account representing an expense purchase	\$50 -
Credit some account representing a liability	\$50 -

or, more specifically,

June 30	
Salaries	\$50 -
Tom Harper	\$50 -

The debit correctly records an increase in the expense purchases in Salaries account. The credit to Tom Harper's account, however, although correct, is not desirable because it multiplies the number of accounts with creditors, and also mixes this account with the accounts of creditors from whom merchandise has been purchased.

A standard method of recording accrued liabilities will now be given.

Using the same problem as above, the entry may be:

June 30		
(1) Salaries.....	\$50 -	
Accrued Liabilities.....		\$50 -
To record the accrual of 10 days' salary at the rate of \$30 per week owed to Tom Harper.		

The account, Accrued Liabilities, is substituted for the account, Tom Harper, because it is a general term that will serve as a title for all accrued liabilities. It is desirable to use it as a temporary account from which, to show the cause of the accrual, the credits are later transferred to various accounts, such as, Salaries, Rent, Taxes, Commission, Interest, etc., as explained below.

Referring to the Harper problem, assume that the Salaries account has been debited \$430 for services received and paid for before the accrual was recorded, then the total in Salaries with the accrual is \$480 which is transferred to Profit and Loss by the entry: .

June 30		
(2) Profit and Loss.....	\$480 -	
To Salaries.....		\$480 -
To transfer the amount of expense consumed in operating the business to Profit and Loss account, to find the <i>net profit</i> .		

The third entry is a matter of convenience only and may be made at this time or at the end of the next accounting period. It merely transfers the liability from the accrued account to Salaries account as referred to above. The only advantage in making the transfer at the end of this period is in the use of the old date (for this item, June 30). This calls attention to the item and indicates that it should be examined. The date, June 30, indicates that the transfer was made during this period, immediately after closing the ledger.

June 30

(3) Accrued Liabilities.....	\$50 -	
Salaries		\$50 -
To transfer the liability of unpaid salary from Accrued Liabilities account to Salaries account for convenience in determining what amount of the sub- sequent debits to this account represent increase in expense purchases for the new period, and what amount represents decrease in liabilities previously recorded.		

The next entry is not part of the closing entries, but is given to explain more fully the nature of accrued liabilities.

Assume that on July 5 you paid Tom Harper \$60 for salary (services) for the two weeks ended July 4. The transaction is recorded as follows:

July 5

(4) Salaries.....	\$60 -	
Cash.....		\$60 -
Paid Tom Harper cash for services as clerk for the two weeks ended July 4.		

The effect of the debit of \$60 to Salaries is to decrease the liability of \$50 recorded June 30 appearing on the credit side of Salaries account, and to increase the expense purchase, services received from Tom Harper since June 30, by \$10.

Entry (3) may be omitted if entry number (4) for July 5 is made as follows:

July 5

Accrued Liabilities.....	\$50 -	
Salaries.....	10 -	
Cash.....		\$60 -

This shows clearly that the payment of \$60 to Tom Harper for services has decreased a liability \$50; increased an expense purchase (services) \$10, and decreased the asset, cash, \$60. However, as a matter of ease and convenience, the routine of entries

(1), (2), (3), and (4) is almost invariably followed. The book-keeper does not then need to stop to see if some portion of the payment is in settlement of an accrued liability. It is all recorded in the expense purchase account where the previous credit automatically takes care of the portion of the payment made to settle the liability, while the remainder shows the amount of the expense purchase applicable to the new period. The payment is, therefore, recorded in exactly the same way as every other payment. The bookkeeping routine can be followed without change or thought, saving considerable time.

All the accrued liabilities may be recorded in the same manner as salaries. The usual practice is to record all the accrued liabilities in one compound entry, as follows:

Salaries.....	\$ 50 -
Wages.....	70 -
Taxes.....	210 -
Accrued Liabilities.....	\$330 -

The appearance of the accounts, Accrued Liabilities and Salaries, after posting the items from journal entries (1) to (4) is shown below. As you trace each numbered item (1) to (4) explain what effect it has on assets, liabilities, or capital.

SALARIES

19— June 30	Previous entries (1) J 15	430 - 50 - 480 -	19— June 30	P. & L.	(2) J 16	480 - 480 - 50 -
July 5	(4) J 21	60 -	June 30		(3) J 16	
ACCRUED LIABILITIES						
19— June 30	(3) J 16	50 -	19— June 30	Salaries	(1) J 15	50 -
	J 16	70 -		Wages	J 15	70 -
	J 16	210 -		Taxes	J 15	210 -
		330 -				330 -

Accrued Assets.—What is a liability to one person is an asset to another. Thus the claim—the account receivable asset—which a firm has against a customer for, say, \$500, is a liability of the customer. On the customer's balance sheet he would be shown as owing \$500 to the firm. So the wages, rent, and interest mentioned above as liabilities are, from the standpoint of the employee, the landlord, and the money-lender, claims which they have against the business and therefore assets. Hence what has been said about accruing liabilities applies also to accruing assets. The business may at times be in the position of a landlord, a money-lender, or even an employee. Thus, on notes receivable, the interest, accruing or accumulating day by day, may be due, in accordance with custom or agreement, at the end of the period of use of the money. If the end of the fiscal period falls before the date when the interest is due, the asset, claim for interest earned to the end of the fiscal period, must be recorded, since usually no record is made until the interest is due or paid. So, also, if the business rents any of its building to a tenant, and the time for payment of the rent has not arrived by the end of the fiscal period, the claim for rent accumulated represents an increase in assets and must be recorded. These assets, therefore, which have been accumulating day by day, which have not been received—and usually are not due because the customary date of payment has not arrived—and have not yet been recorded are called **accrued assets**. Both accrued liabilities and accrued assets are spoken of as **accruals**.

Recording Accrued Assets.—To illustrate the method of recording accrued assets, assume that you own a building which you leased to George Bennett on April 30, 19-, at \$300 per month, payment to be made at the end of each 3 months' tenancy. The first payment of \$900 will be due July 31. It is now June 30; therefore Bennett owes you \$600 for rent, but under the terms of the lease payment is not yet due. Your claim against Bennett for \$600 is an accrued asset. The item has not been entered on

the books, although it has been earned, because in the ordinary course of events it would be recorded at the time of payment, July 31. If you desire to know your financial condition on June 30, the amount of this asset must be added to your other assets. With the increase in assets evidenced by the \$600 claim against Bennett, there is an equal increase in capital, because liabilities have not changed.

The plan for recording accrued assets is similar to that for recording accrued liabilities.

In general terms the accrual may be analyzed as follows:

June 30	
Debit some account representing an asset	\$600 -
Credit some account representing a capital increase	\$600 -

or, more specifically, the journal record would be:

June 30	
George Bennett	\$600 -
Rent	\$600 -

This indicates an increase in the asset, claim against George Bennett, and an increase in capital recorded under the title, Rent. The debit to George Bennett is not altogether desirable because it mixes this account with the accounts of customers to whom merchandise is sold.

A standard method of recording accrued assets will be explained.

The entries when made in accord with the analysis of the transaction will be:

June 30	
(1) Accrued Assets	\$600 -
Rent	\$600 -
To record the accrual of 2 months' rent of building at \$300 per month owed by George Bennett as per lease of April 30, 19—.	

The account, Accrued Assets, has been substituted for the account, George Bennett, because it is a general term that will

serve as a title for all accrued assets. It is generally more convenient to use it as a temporary account from which, to show the cause of the accrual, the debits will be transferred to the various accounts, such as Rent, Taxes, Commission, Salaries, Interest, etc. To illustrate, assume that the Rent account has been credited \$1,000 for rents paid by tenants, then the total credited to Rent, including the accrual of \$600 owed by Bennett, is \$1,600, which is transferred to Profit and Loss as follows:

June 30		
(2) Rent.....	\$1,600 -	
Profit and Loss.....		\$1,600 -
To transfer the amount of rent, indicating increase in capital, to Profit and Loss account, to find the <i>net profit</i> .		

The third entry merely transfers the asset from the accrued account to the Rent account to offset the subsequent credit and indicate how much of the credits for the next period represents decrease in asset and how much increase in capital.

June 30		
(3) Rent.....	\$600 -	
Accrued Assets.....		\$600 -
To transfer the asset, uncollected claims for rent, from Accrued Assets to Rent account for conven- ience in determining what amount of subsequent credits to this account represents increase in capital and what amount represents decrease in assets previ- ously recorded.		

The next entry has nothing to do with the closing entries of the old period, but is given to illustrate more fully the nature of accrued assets. Assume that George Bennett paid you \$900 in cash for 3 months' rent on July 31. This will be recorded as follows:

July 31		
(4) Cash.....	\$900 -	
Rent.....		\$900 -
Received from George Bennett \$900 in cash for rent of building at 742 Park Ave., for the 3 months ended July 31.		

The effect of the \$900 credit to Rent is to decrease the asset, consisting of our claim against George Bennett, \$600, recorded originally (June 30) as a debit to Accrued Assets and then transferred as a debit to Rent, and to show the increase of capital, \$300, in the form of rent services rendered which accumulated during July. All of this \$300 has now been earned and will increase capital (net profit).

Entry (3) may be omitted if entry number (4) for July 31 is made as follows:

July 31

Cash	\$900 -
Accrued Assets.....	\$600 -
Rent.....	300 -

This shows clearly that the payment of \$900 by George Bennett for rent has increased the asset, Cash, \$900, decreased the asset, Accrued Assets, \$600, and increased capital by means of rent earnings, \$300.

The appearance of Accrued Asset account and the Rent account after posting items (1) to (4) from the journal are shown below. As you trace each numbered item (1) to (4), explain the effect it has on assets, liabilities, or capital.

RENT

19— June 30	P. & L. (2) J 18	1,600 -	19— June 30	Previous entries (1) J 18	1,000 - 600 -
		1,600 -			1,600 -
June 30	(3) J 18	600 -	July 31	(4) J 26	900 -
ACCRUED ASSETS					
19— June 30	Rent (1) J	600 -	19— June 30	(3) J 18	600 -

Summary.—In all accruals there is an increase either in liabilities or in assets. In recording accrued liabilities, a debit to some expense purchase account shows the increase in it, while the credit, whether shown in liability account or to the “new” portion of the same expense purchase account, indicates the liability accrued. Thus, in the case of the \$50 salary owed to the clerk, the increase in the expense purchase has been consumed in selling the goods—may be said to have been given with the goods—and therefore a decrease in capital has resulted. The amount owed to the clerk increased the liabilities, and this liability still exists as shown in the Accrued Liabilities account or in the “new” portion of Salaries account.

In recording accrued assets, a debit to some account indicates an increase in assets, while the credit shows ultimately the increase in capital resulting therefrom.

The same method used to record accrued liabilities is used to record accrued assets. Other methods are made use of, but the one shown here is preferred. The student must study this chapter very carefully, for without an adequate understanding of the matters treated here he is not ready to take up what follows.

QUESTIONS

1. What is meant by “accruals”?
2. How many groups of accruals are in use? Name them.
3. What is an accrued liability? Incurred liability?
4. Give five examples of accrued liabilities.
5. Does the accrued liability cause an increase in assets? Explain.
6. Are the increased assets in existence?
7. In general terms give the journal entry to record an accrued liability.
8. Give all journal entries with explanations for recording accrued liabilities.
9. (a) What is an accrued asset? (b) Give five examples.
10. Does the accrued asset cause an increase in liabilities? Explain.
11. In general terms give the journal entry to record an accrued asset.
12. (a) Give all journal entries with explanations for recording accrued assets.
- (b) Set up the various ledger accounts affected.

13. (a) Give all journal entries with explanations for recording accrued liabilities.

(b) Set up the various ledger accounts affected.

14. What is the net effect on capital of accrued liabilities? Explain.

15. What is the net effect on capital of accrued assets? Explain.

PROBLEMS

1. On December 31, 1920, the date of closing your books, you owe \$370 for taxes for the current year, payable January 31, 1921.

(a) Write the necessary journal entries with explanations to close your books December 31.

(b) Post to the proper accounts and show the accounts closed.

2. You are closing your books for the year ended September 30. Your Salaries account shows previous debits of \$800 but this does not include \$125, which you owe your clerk, Clyde Jenkins, for one-half month's services. On October 15 you paid Jenkins \$250 for 1 month's services.

(a) Write the necessary journal entries with explanations to close the books.

(b) Post to the proper accounts and show the accounts closed.

(c) Journalize and post the October 15 payment.

3. You rent part of your store to Joseph Mills at \$150 per month. December 31, 1920, Mills owes you \$450 for 3 months' rent. January 31, 1921, Mills sends you check for \$600 for 4 months' rent.

(a) Write the journal entries to close your books December 31.

(b) Post to the proper accounts and show the accounts closed.

(c) Journalize the receipt of the \$600 check January 31 and post the entry.

4. James K. Hill leased a store building to Samuel Towers for one year from January 1, 19—, at \$200 per month, rent to be paid in advance monthly. All rent was paid up to June 30, a period of 6 months. But nothing has been paid since June. November 1 Towers paid all back rent and rent for November.

(a) Write journal entries to close Hill's books September 30.

(b) Post to the proper accounts and show the accounts closed.

(c) Write the journal entry on Hill's books to record Towers' payment, after which post to the ledger.

5. From the information in Problem 4—

(a) Write the journal entries to close Towers' books September 30.

- (b) Post to the proper accounts and show the accounts closed.
 (c) Write the journal entry to record the payment to Hill on November 1 and post.

6. From the following trial balance and additional information:

- (a) Write journal entries to close Gardner's books on June 30, 19—.
 (b) Post to the proper accounts and show the accounts closed.
 (c) Write journal entry to record payment of rent on July 15 and post.

JOSEPH GARDNER, TRIAL BALANCE, JUNE 30, 19—

Cash.....	\$ 250	—		
Merchandise Inventory.....	500	—		
Accounts Receivable.....	375	—		
Merchandise Purchases.....	920	—		
Merchandise Sales.....			\$1,090	—
Expense.....	45	—		
Accounts Payable.....			150	—
Joseph Gardner, Capital.....			850	—
	\$2,090	—	\$2,090	—

Additional information June 30, 19—: merchandise inventory \$510; store building was rented from Frank Smith at \$100 per month payable the 15th of each month. Rent for June has not yet been paid. The expense item of \$45 was consumed in conducting the business.

Note. It is advisable to make journal entries for all accruals before writing the closing journal entries.

7.

RALPH MOSER, TRIAL BALANCE, NOVEMBER 30, 19—

Cash.....	\$ 4,780	—		
Merchandise Inventory.....	1,200	—		
Merchandise Purchases.....	9,895	—		
Merchandise Sales.....			\$10,890	—
Notes Receivable.....	200	—		
Accounts Receivable.....	750	—		
Rent.....	200	—		
Salaries.....	150	—		
Accounts Payable.....			2,285	—
Ralph Moser, Capital.....			4,000	—
	\$17,175	—	\$17,175	—

Additional information November 30, 19—: merchandise inventory \$1,825; salary due Charles Costello, but not payable until Saturday, December 3, \$135; rent was paid to November 30, 19—; commission accrued on sales made for Horace Browne but not payable until December 1, 19—, \$25.

From the above trial balance and additional information—

- (a) Write journal entries to close Moser's books November 30, 19—.
- (b) Post to the proper accounts and show the accounts closed.
- (c) Write the journal entries to record the payment of Costello's salary on December 3 and the receipt of cash for commission earned on December 1 and post to the proper accounts.

8.

GEORGE WILDMAN, TRIAL BALANCE, JUNE 30, 19—

Cash.....	\$ 6,500	—		
Merchandise Inventory.....	1,500	—		
Merchandise Purchases.....	3,000	—		
Accounts Receivable.....	4,500	—		
Merchandise Sales.....			\$ 4,000	—
Accounts Payable.....			1,500	—
Rent.....	300	—		
Expense.....	600	—		
George Wildman, Drawing.....	300	—		
George Wildman, Capital.....			11,200	—
	\$16,700	—	\$16,700	—

Additional information: merchandise inventory \$1,700; rent prepaid 1 month \$150; electric light accrued \$25; expense inventory \$200.

From the above trial balance and additional information:

- (a) Write journal entries to close Wildman's books as of June 30, 19—.
- (b) Open a ledger from above trial balance.
- (c) Post the adjusting and closing entries and show the accounts closed.
- (d) Take a post-closing trial balance.
- (e) Prepare a balance sheet.
- (f) Prepare a profit and loss statement for the 6 months ended June 30.

CHAPTER XVI

INTEREST

Purpose of Chapter.—

1. The nature of interest cost and income.
2. The nature of bank discount.
3. Methods of calculating interest.
4. Journal entries to record interest on notes.

Definition of Interest.—In previous chapters explanation has been made of various expense and income accounts to show their purpose and use in keeping track of certain types of information vital to the proper conduct of business. In this chapter it is purposed to explain another expense and another income account, Interest Cost and Interest Income.

Interest may be defined as the charge made for the right to use money borrowed for a given period of time. Only during the last few centuries has the morality of making such a charge been thoroughly established. Formerly it was not considered right to charge another for the use of money lent him. Interest is practically the same as rent. If a building—business or apartment house—owned by one man is leased to another, the owner always requires the tenant to pay for the use of his property. The charge made for the right to use the building is known as **rent**. There are, however, two points of difference between leasing a building and borrowing money: (1) If a building is rented, the identical building must be returned, while in the case of money borrowed any dollars amounting to the same total as the dollars borrowed may be returned; (2) title to the building does not pass to the one using it (**lessee**), i.e., the building remains the property of the owner (**lessor**), whereas the money borrowed actually becomes the property of the borrower.

Back of both the rent and interest charges is the idea of rendering a service valuable to the user. There is no compulsion upon the owner to allow another to use his property. If the other party can use the property to advantage, he is willing to pay for that use. If one can use the services of a lawyer or of a broker or agent in selling his goods, he is willing to pay for such services. In the same way, if a business man can use with profit the money which another has accumulated he is willing to pay for its use. This right to use money or the charge made for this right is called "interest." From the standpoint of the borrower it is *interest cost* or *interest expense*, while from the standpoint of the lender it is *interest income*. In practice, the amount charged is almost invariably in proportion to the time during which the money is used, the standard method being so many per cent, based on a year's use. Thus, interest at the rate of 6% means a charge of 6 cents for each dollar borrowed for one year's time. If the money is used for a shorter period, a proportionately smaller amount will be charged. Thus, if \$1 is borrowed for 6 months' time, the charge would be 3 cents; for 3 months, 1 1/2 cents. Wherever the interest rate is given without qualification as to length of time, a year's time is understood as the basis.

The Rate of Interest.—The maximum rate charged for the use of money is governed by the laws of the state where the money is borrowed. The interest charge usually begins at the time the money is borrowed. If a promissory note is given and no mention of interest is made or it specifies "without interest," no interest can be charged up to the date of maturity, but from that date the note will bear interest at the legal rate. So, too, interest may be charged on past-due accounts. In many states the legal rate is 6%, while in others it may be 5% or even 8%. In some states the legal and maximum rates are the same, while in others 12% is permitted, and in a few states any rate the parties agree upon may be charged. If the maximum rate is

higher than the legal rate, the rate must be specified. If more than the legal maximum rate is charged, it is termed **usury**, the penalty for which depends on the laws of the state where the agreement was made, ranging from the loss of the interest charged above the legal rate to the loss of both principal and interest. The student should look up the laws of his state in regard to interest.

Interest Cost.—Interest cost usually arises in connection with notes payable. When money is borrowed, it is customary to give the lender a promissory note, or a formal promise to pay the sum borrowed at a definite future time, together with the interest charge for its use. Borrowing money without a formal promise to pay, a word-of-mouth promise being deemed sufficient, is not met with in business, although sometimes resorted to among friends. The student will see in a later chapter (XXVI) how the bank serves the business community in lending money. In borrowing money from a bank it is customary to pay the interest in advance instead of at the maturity of the loan. Thus, if A desires to borrow \$1,000 at 6% for 2 months' time, the banker, instead of giving \$1,000, turns over \$990, deducting his interest of \$10 at the beginning of the loan. When A pays back the loan, he will pay \$1,000. The transaction is the same as if the banker had turned over the full amount, \$1,000, and the borrower had immediately paid his interest of \$10 instead of waiting until the maturity of the loan.

In the case of other loans than those made by a banker, the interest is not paid until the maturity of the loan. Thus, if Dennis borrows \$1,000 at 6% for 2 months' time from Wright, Dennis will receive \$1,000 which he will use for the 2-month period. When he repays the loan, he will return to Wright not only the \$1,000 borrowed but the \$10 interest. In all, Dennis will thus pay \$1,010. In the case of long-term loans extending more than a year or even 6 months, it is not an infrequent provision that the interest shall be paid at the end of certain definite

periods until the maturity of the loan, such as every 6 months or every year. Thus, in the case of \$1,000 borrowed for 3 years at 6 %, interest payable annually, at the end of the first year the borrower would pay \$60 for interest to the lender for that year, and similarly \$60 at the end of the second and third years.

Analysis of Interest Cost.—We may analyze interest cost under two heads, namely, when paid in advance, and when paid at maturity.

When paid in advance, the interest cost is an asset, just as rent paid in advance or insurance purchased. The method of recording is therefore the same as that of any other asset purchased. The item is a charge or debit to the Interest Cost account. If a cash payment was made to cover the cost, Cash is credited to show the decrease of the asset, Cash. Day by day, as we use the borrowed money the interest paid in advance is consumed. It is not customary, however, to make an entry each day to show how much paid-in-advance interest has been used that day. At the end of the fiscal period, in determining the status of every account, it is necessary to determine how much of the interest paid in advance has been used, that amount constituting the interest expense charge for the period. The unused portion will be an asset and will be carried over into the next period.

In the case of interest which is not paid until the end of an agreed time, that is, until the money has been used, the item is a consumed asset. This we call an expense, that is, money spent for which there is no direct tangible return. When money is spent in the purchase of a stock of merchandise, there is a tangible return for the asset given in exchange. When money is spent for the use of another asset, as in the case of borrowed money, while the use of that asset has brought something of value to the business, it is not a tangible thing but something which will be reflected in increased profits for the period. The item is of somewhat the same nature as salesmen's salary expense. The business

man exchanges his cash for the services of his salesmen. That service is not a tangible asset, but he can secure a better price for his commodity because he has a store and a sales force to take care of customers. However, at the time of paying the salesman's salary it is neither customary nor considered good business practice to charge the salesman's salary as an increase in the value of the merchandise dealt in. The return from the money given the salesman for his service is secured only when the goods are sold, never previous to that time. Hence, it is the standard practice to treat it as an expense item, and deduct it from the gross profit on sales.

In the same way interest expense, or cost of using money, is to be treated as a deduction from the income or profit that may come from the use of money. In other words, it is a consumed rather than a present asset. Whether the interest payment is made in advance or after the use of the money, standard practice is to charge it to the Interest account. The exact nature of the account, therefore, is determinable only upon analysis made at the end of a regular fiscal period to show accurate results of business operations for that period.

Interest Income.—Just as rent income represents income from allowing the use of a building, so interest income is income from selling the right to use money. What constitutes *interest cost* from the standpoint of the borrower becomes *interest income* from the standpoint of the lender. The analogy between interest cost and interest income is similar to that between accounts payable and accounts receivable, to this extent: Both items arise from the same transaction. Just as an account receivable from the standpoint of the seller is an account payable from the standpoint of the buyer, so an interest cost from the standpoint of the borrower of money is an interest income from the standpoint of the lender. In the first illustration on page 244 the bank lending money received from A income to the amount of \$10 before any return was given for it. In the second illustration

Wright, the lender, does not receive the \$10 until the end of the 2 months' time during which Dennis has had the use of the money. Hence, Wright will receive not only the \$10 in payment for use of the money but also the \$1,000 return of the money lent.

In the case of a long-term loan, as explained above, by agreement the interest is to be received at certain stated periods, and at the end of the last period the principal sum loaned will also be received.

Analysis of Interest Income.—The analysis of interest income will be discussed under the two heads: income received in advance, and income received after the money has been used.

In the first illustration given above under interest cost, the bank allows the borrower to use the money for 2 months. The bank is therefore liable on the date of the receipt of the \$10 for 2 months' use of its money by A. The \$10 will consequently be shown as a liability, i.e., a credit in the Interest Income account. Day by day, through the borrower's use of the money, the liability is being canceled and an income item, an increase of capital, is taking its place. This item records the income received for the service rendered by the bank. It is not customary to record this cancellation of the bank's liability daily, but only at the end of the fiscal period. If at that time the bank's contract with the borrower still has some time to run, a portion of the account must still be shown as a liability, while the rest represents income from the use of the money during the period. This is an illustration of an increase in capital through a decrease in liabilities.

In the second illustration, in which Wright does not receive his interest income until after he has allowed the use of his money for the agreed time, the entire \$10 is an income item and must be so treated. Except in the case of banks, it is not customary to book an interest income item until after the service has been rendered to the borrower.

Usual Methods of Obtaining Money.—The principal sources from which one may obtain the use of other people's money are as follows:

1. From a bank.
2. From a money-lender.
3. From creditors who extend time of payment on condition that interest be paid.
4. From friends.

The usual practice is to obtain the necessary money from the first three sources.

The methods of obtaining the money are:

1. By giving a promissory note without interest for the exact amount of the money borrowed.
2. By giving a promissory note with interest. This may be with or without security, i.e., the one giving the note may mortgage all or part of his property or give collateral security for the payment of the note, or he may merely sign the note and not pledge property which may be sold upon failure to pay the note.
3. By paying interest on overdue accounts payable.
4. By selling (discounting)—
 - (a) His own note without interest.
 - (b) Another's note (note receivable) without interest.
 - (c) Another's note with interest.
5. By giving his own note with interest included in the face of the note.

Calculating Interest.—Since most interest problems occur in connection with notes, we shall explain the methods of calculating interest under various conditions.

1. Finding the Date of Maturity of Notes.—If the time is given in months, a calendar month is understood, and the note will be due the corresponding date in one of the succeeding

months. For example, a 3-months' note dated January 5 will be due the 5th day of a month 3 months later, or April 5. If the corresponding date does not appear in the final month of the term, the note will be due on the last day of that month. For example, notes dated December 29, 30, 31, for 2 months, will be due February 28 of the following year, or in leap years, February 29.

If the time is given in days, count the exact number of days forward, excluding the date the note is given and including the date of maturity.

Example: A 90-day note dated June 8 will be due September 6.

SOLUTION: This is obtained as follows: Excluding the date given, we have—

Remaining in June.....	22 da.
“ “ July.....	31 “
“ “ August.....	31 “
	<u>84</u> “
Required in September.....	6 “
Total.....	90 “

If the time is 30 days or even multiples of 30 days, an easy method for finding the due date is to add 30 days at a time. In the example above we would proceed as follows:

30 days forward from June 8 gives July 8; 30 days forward again gives August 7; and 30 days additional gives September 6.

2. Computing the Time Between Two Dates.—Three methods of finding the time between two dates are given below:

Counting Actual Number of Days. This will be used only where the period is less than one year.

Example: Find the number of days between November 14, 1920, and January 26, 1921.

SOLUTION:

Remaining in November.....	16 da.
“ “ December.....	31 “
Required “ January.....	26 “
Total.....	73 “

Compound Subtraction. This may be used for a period of any length.

Example: Find the time between July 27, 1919, and April 2, 1921.

SOLUTION: Write the first date below the last date and subtract. If the days and months in the lower date line are larger than the days and months in the upper date line, reduce one month to days and one year to months.

Year	Month	Day
20	15	32
1921	4	2
1919	7	27
1	8	5

Bankers' Time. This is used by some banks for periods of more than one month. State the time in months and days by taking the whole months and the actual days in the fraction of the month remaining.

Example: Find the time between February 15, 1921, and November 7, 1921.

SOLUTION:

From Feb. 15 to Oct. 15 is..... 8 mo.
 " Oct. 15 " Nov. 7 "..... 23 da.
 Total..... 8 mo. 23 da.

3. The 60-Day Method.—Of the several methods for finding interest, most use 360 days as a year, which is considered as composed of 12 months of 30 days each. Since most notes are given for 30, 60, or 90 days, the 60-day method is convenient. It affords a positive check on solutions and requires only the simple operations of addition and division.

It is readily seen that the interest on—

\$1 for 1 yr. at 6% is.....	\$.06
1 " 2 mo. or 60 da. at 6% (1/6 of a yr.) is.....	.01
1 " 6 da. at 6% (1/10 of 60 da.) is.....	.001
1 " 600 da. at 6% (10 × 60 da.) is.....	.10
1 " 6,000 da. at 6% (100 × 60 da.) is.....	1.00

Therefore, to find the interest on any sum of money for 60 days (2 months) at 6%, multiply by \$.01, which is equivalent to moving the decimal point two places to the left. For 6 days the decimal point is moved three places to the left; for 600 days one place to the left. For 6,000 days the decimal point is not moved because the interest will be the same as the principal.

Example: Find the interest on \$384.72 for 60 days at 6%.

SOLUTION: The interest on \$1 for 60 days at 6% is \$.01.

The interest on \$384.72 is $384.72 \times $.01$, or \$3.8472. Since 7 mills is more than $\frac{1}{2}$ cent we add an additional cent, making the interest \$3.85.

From this it is evident that the interest for 6 days at 6% will be $\frac{1}{10}$ of the interest for 60 days, therefore the decimal point is moved one additional place to the left, or 3 places to the left in the original principal. Using the same example, but changing the time to 6 days we have,

$$384.72 \times $.001, \text{ or } \$3.8472$$

If the time is not 60 days, the same method may be used by dividing the time so that the interest for each part may be found from a previous part, or from 60 days.

Example: Find the interest on \$384.72 for 52 days at 6%.

SOLUTION:

$$\begin{array}{rcl}
 \$384.72 & = & \text{int. for 60 da. at 6\%} \\
 19236 & = & \text{int. for 30 da. at 6\% (1/2 of 60)} \\
 12824 & = & \text{" " 20 " " 6 (1/3 of 60)} \\
 1282 & = & \text{" " 2 " " 6 (1/10 of 20)} \\
 \hline
 \$33342 & = & \text{int. for 52 da. at 6\%}
 \end{array}$$

NOTE: To secure accuracy carry out all calculations to four decimal places.

Examples may be checked by dividing the time into different parts of 60 days. The following solution affords a check on the above example.

$$\begin{array}{r}
 \$3 \overline{)84.72} = \text{int. at } 6\% \text{ for } 60 \text{ da.} \\
 \underline{1 \overline{)2824}} = \text{int. for } 20 \text{ da. at } 6\% \text{ (1/3 of } 60) \\
 1 \overline{)2824} = \text{ " " } 20 \text{ " " } 6 \text{ (1/3 of } 60) \\
 \underline{3847} = \text{ " " } 6 \text{ " " } 6 \text{ (1/10 of } 60) \\
 3 \overline{)847} = \text{ " " } 6 \text{ " " } 6 \text{ (1/10 of } 60) \\
 \hline
 \$3 \overline{)3342} = \text{int. for } 52 \text{ da. at } 6\%
 \end{array}$$

Example: Find the interest on \$384.72 for 1 yr. 3 mo. 12 da. at 6%.

SOLUTION:

Time: 1 yr. 3 mo. 12 da. = 15 mo. (14 mo. and 1 mo.) + 12 da.

$$\begin{array}{r}
 \$3 \overline{)84.72} = \text{int. for } 60 \text{ da. (2 mo.) at } 6\% \\
 26 \overline{)9304} = \text{int. for } 14 \text{ mo. at } 6\% \text{ (7 } \times \text{ 2 mo.)} \\
 1 \overline{)9236} = \text{ " " } 1 \text{ " " } 6 \text{ (1/2 of 2 mo.)} \\
 \underline{7694} = \text{ " " } 12 \text{ da. " } 6 \text{ (1/5 of 60 da.)} \\
 \hline
 \$29 \overline{)6234} = \text{int. for } 15 \text{ mo. 12 da. at } 6\%
 \end{array}$$

To find the interest at any rate, first find the interest at 6% as explained, and then divide by 6 to find the interest at 1%, after which multiply by the required rate.

Example: Find the interest on \$420 for 60 days: (a) at 3½ %; (b) at 5%.

SOLUTION:

$$\begin{array}{r}
 \text{(a) Divide by 6) } \$4 \overline{)20} = \text{int. 60 da. at } 6\% \\
 \underline{70} = \text{int. 60 da. at } 1\% \\
 3 \text{ } 1/2 \\
 \hline
 \left. \begin{array}{r} 2 \overline{)35} \\ 2 \overline{)10} \end{array} \right\} \text{multiplied by } 3 \text{ } 1/2 \\
 \hline
 \$2 \overline{)45} = \text{int. 60 da. at } 3 \text{ } 1/2\%
 \end{array}$$

$$\begin{array}{r}
 \text{(b) Divide by 6) } \$4 \overline{)20} = \text{int. 60 da. at } 6\% \\
 \underline{70} = \text{int. 60 da. at } 1\% \text{ (Subtract)} \\
 \hline
 \$3 \overline{)50} = \text{int. 60 da. at } 5\%
 \end{array}$$

4. Variation of the 60-Day Method.—The principle involved in the 60-day method may be applied at different rates as follows:

Example: Find the interest on \$420 for 72 days at 5%; 90 days at 4%.

SOLUTION: If it requires 360 days to earn \$.05 on \$1, it will require $\frac{1}{5}$ of 360 days, or 72 days, to earn \$.01. Then a 5% rate becomes the 72-day method and a 4% rate becomes the 90-day method, etc.

\$4|20 = int. 72 da. at 5%

\$4|20 = int. 90 da. at 4%

The number of days required to earn \$.01 on \$1 at a given rate may be found by dividing 360 days by the number representing the rate. The following table gives the rates most conveniently used:

Rate	Cents Earned on \$1 in 360 Days	Period Required to Earn \$.01 on \$1	
		Part of a Year of 360 Days	Number of Days
1%	.01	1	360
1 $\frac{1}{2}$	.01 $\frac{1}{2}$	$\frac{2}{3}$	240
2	.02	$\frac{1}{2}$	180
2 $\frac{1}{2}$	.02 $\frac{1}{2}$	$\frac{2}{5}$	144
3	.03	$\frac{1}{3}$	120
4	.04	$\frac{1}{4}$	90
4 $\frac{1}{2}$	.04 $\frac{1}{2}$	$\frac{2}{9}$	80
5	.05	$\frac{1}{5}$	72
6	.06	$\frac{1}{6}$	60
7 $\frac{1}{2}$	.07 $\frac{1}{2}$	$\frac{2}{15}$	48
8	.08	$\frac{1}{8}$	45
9	.09	$\frac{1}{9}$	40
10	.10	$\frac{1}{10}$	36
12	.12	$\frac{1}{12}$	30
15	.15	$\frac{1}{15}$	24
18	.18	$\frac{1}{18}$	20
20	.20	$\frac{1}{20}$	18
24	.24	$\frac{1}{24}$	15

Example: Find the interest on \$567.24 at 4 $\frac{1}{2}$ % for 84 days.

SOLUTION:

$$\begin{array}{r}
 \$1 \text{ at } 4 \frac{1}{2}\% \text{ for } 80 \text{ da.} = \$0.01 \\
 \$5 \overline{) 67.24} = \text{int. } 80 \text{ da. at } 4 \frac{1}{2}\% \\
 \underline{28 \ 36} = \quad \quad 4 \quad \quad 4 \frac{1}{2} \quad (\frac{1}{2} \text{ of } 80) \\
 \$5 \overline{) 95 \ 60} = \text{int. } 84 \text{ da. at } 4 \frac{1}{2}\% \\
 \qquad \qquad \qquad \$5.96 \text{ Ans.}
 \end{array}$$

5. Interchanging Principal and Time.—In some problems the interest computation is simplified by interchanging the numbers representing the principal and the time.

Example: Find the interest on \$300 at 6% for 92 days.

SOLUTION (a)

$$\begin{array}{r}
 \$3 \overline{) 00} = \text{int. } 60 \text{ da. at } 6\% \\
 3 \overline{) 00} = \text{int. } 60 \text{ da. at } 6\% \\
 1 \overline{) 50} = \quad \quad 30 \quad \quad \quad 6 \\
 10 = \quad \quad \quad 2 \quad \quad \quad 6 \\
 \$4 \overline{) 60} = \text{int. } 92 \text{ da. at } 6\%
 \end{array}$$

SOLUTION (b)

Interchanging principal and time, the problem would read: Find the interest on \$92 at 6% for 300 days.

$$\begin{array}{r}
 \$9 \overline{) 20} = \text{int. } 600 \text{ da. at } 6\% \\
 \$4 \overline{) 60} = \text{int. } 300 \text{ da. at } 6\% (\frac{1}{2} \text{ of } 600)
 \end{array}$$

6. To Find the Accurate Interest.—Accurate or exact interest is based on 365 days to the year. It is more troublesome to compute and therefore not so generally used in ordinary commercial computations. Where accurate interest is desired it may be found by first finding the interest on the basis of 360 days and then deducting $\frac{1}{73}$ of this interest. The difference between 365 days and 360 days is 5 days, which is $\frac{1}{73}$ of 365 days, the new divisor. Since the divisor, 365, is $\frac{1}{73}$ larger than 360, the quotient will be $\frac{1}{73}$ smaller.

Example: Find the accurate interest on \$730 at 6% for 60 days.

SOLUTION:

$$\begin{array}{r}
 \text{Divide by } 73) \$7 \overline{) 30} = \text{int. } 60 \text{ da. at } 6\% (360 \text{ da. to the year}) \\
 \underline{10 = \frac{1}{73} \text{ of } \$7.30} \quad \text{(Subtract)} \\
 \$7 \overline{) 20} = \text{int. } 60 \text{ da. at } 6\% (365 \text{ da. to the year})
 \end{array}$$

Both accurate and ordinary commercial interest may be found readily by using interest tables.

Finding the Amount.—The amount of a debt without interest is the face of the debt at maturity, which begins to bear interest at the legal rate only after maturity. The amount of a debt with interest is the sum of the principal and the interest to maturity.

Example: Find the amount of \$420 for 66 days at 6%.

SOLUTION:

$$\begin{array}{rcl}
 \$420 & = & \text{int. 60 da. 6\%} \\
 42 & = & \text{" 6 " 6\%} \\
 \hline
 462 & = & \text{int. 66 da. 6\%} \\
 420 & = & \text{principal} \\
 \hline
 \$462 & = & \text{amount}
 \end{array}$$

Discounting Notes.—Another interest problem arises when notes are sold. Since the note is a promise to pay money at a future date it is evidently not worth its final or maturity value at any date before maturity. As a result of custom and later of law, the maturity value or amount (principal plus interest) of a note is taken as the base, and the interest from the date of sale to maturity (**discount**) is computed on this amount. The one purchasing the note gives up the use of his money from the date of discount to the date of maturity and is therefore entitled to interest for the time he must wait until the money is repaid. The seller of the note (**discount**er) gets approximately the present value of the note in the form of money or credit, while the buyer of the note (**lender**) agrees to wait a certain time for his money, for the use of which he has received payment in advance.

Example: John Jones owns a 60-day note for \$500 without interest, dated June 15, 1920, and signed by William Watson. Jones needs money and arranges to sell (discount) the note to the bank on the same date, the interest rate being 6%.

SOLUTION: Since the note does not bear interest, the bank will receive at maturity \$500. At the rate of 6% for 60 days the interest is \$5. The bank deducts \$5 from \$500 and gives Jones \$495 in money.

This is an ordinary interest problem except that the \$5 for the use of \$500 is taken in advance; and that Jones receives only \$495. This, of course, makes the actual rate more than 6% and favors the money-lender. To make the rate exactly 6% one would have to find what sum of money placed at interest at 6% would amount to \$500 in 60 days, i.e., the true present worth of \$500 at 6% for 60 days. However, due perhaps to the fact that it favors the money-lender and is more easily computed, the amount due at maturity is used as the base in discount problems.

Expressions Used in Discount Problems.—The meanings of certain expressions used in discount problems and their application are shown below.

1. **Date of maturity** means the date on which the note will be due. See pages 248 to 250.
2. **Term of discount** is the time from the date of discount to the date of maturity. Find the exact number of days. This is the time the lender gives up the use of his money.
3. The **interest** refers to the interest on the note from the date of the note to the date of maturity. This may be at any legal rate.
4. The **principal** is the face of the note.
5. The **amount** is the sum of the principal and interest.
6. The **rate of discount** is the rate of interest charged for the use of the money at the time the note is sold.
7. The **discount** is the interest computed on the amount for the term of discount at the rate of discount.
8. The **proceeds** is the remainder after deducting the discount from the amount, and represents the amount of money the borrower (seller of the note) receives.

Example: You own a 3-month note for \$1,200 with interest at 6% dated September 12, 1920, signed by Charles Burke. On September 30, 1920, you discount this note at 5% at the bank.

SOLUTION:

- (1) September 12, 1920 + 3 mo. = Dec. 12, 1920, date of maturity.
 (2) Sept. 30, 1920 to Dec. 12, 1920 = 73 days, term of discount.

	\$12	00	= int. 2 mo. at 6%
	6	00	= " 1 " " 6
(3)	18		= int. 3 mo. at 6%
(4)	1,200		= principal
(5)	\$1,218		= amount
	\$12	18	= int. 60 da. at 6%
	2	03	= " 10 " " 6
		609	= " 3 " " 6
	14	819	= int. 73 da. at 6%
	2	469	= " 73 " " 1
(6) and (7)	\$12	350	= int. 73 da. at 5%, the discount
(5)	\$1,218		= the amount
-(7)		12	35 = the discount
= (8)	\$1,205	65	= the proceeds

It is understood that the borrower can sell (discount) his own note (note payable) as well as a note signed by another (note receivable).

Booking Interest Cost.—The account title, Interest Cost, includes both interest paid in advance and after the use of the money. Thus, bank discount, which the bank deducts at the time of lending money, is included in the Interest Cost account. Sometimes the title, Interest and Discount, is used to show that both interest as such and interest as bank discount are to be recorded thereunder. There is nothing gained, however, by use of the double title, as the student will know that whether the item is bank discount or interest, it will be recorded under the title, Interest Cost. Several illustrations will be given of transactions involving interest cost.

Case 1. Borrowing Money on a Non-Interest-Bearing Note Payable. A borrows \$1,000 from his banker for 2 months at 6% discounting his note therefor.

The analysis of the transaction shows that A received \$990 cash in return for a promise to pay \$1,000 at the end of 2 months, the \$10 being interest paid in advance. The booking of the transaction will be as follows:

Cash.....	\$990 -
Interest Cost.....	10 -
Notes Payable.....	\$1,000 -

As stated above, the interest cost item is, at the date of making the entry, an asset, a prepaid expense, incurred at the time the money is borrowed. It is much the same as rent paid in advance.

When the loan comes due and is paid, the following entry will be made:

Notes Payable.....	\$1,000 -
Cash.....	\$1,000 -

This shows the decrease of the note payable liability and the decrease of the asset, Cash, caused by the payment of the liability.

Case 2. Borrowing Money on an Interest-Bearing Note, Not Discounted. Dennis borrowed \$1,000 from Wright, a money-lender, for 2 months' time, giving his note and agreeing to pay him interest at the rate of 6% at the maturity of the note. At the time the money is received he will make the following entry:

Cash.....	\$1,000 -
Notes Payable.....	\$1,000 -

When the loan comes due and he repays Wright, he will make the following entry:

Notes Payable.....	\$1,000 -
Interest Cost.....	10 -
Cash.....	\$1,010 -

The debit to Notes Payable indicates the decrease of the former note payable liability of \$1,000; the charge to Interest Cost of \$10 is payment made for the use of the money, an expense item, or consumed asset which causes a \$10 decrease in capital, while the credit of \$1,010 to Cash indicates the decrease of the asset, Cash.

Case 3. Borrowing on the Note Payable with Interest Included in the Face Amount. It sometimes happens that a note, instead of being made interest-bearing is made non-interest-bearing for a larger amount, sufficient to include the interest which would be payable at the date of maturity. This has the advantage of making known at the time of issue the amount of interest that will have to be paid. If you borrow \$1,000 from George Strubie for 60 days, with interest at 6%, you may make either an interest-bearing note for \$1,000 and pay, in settlement, both \$1,000, the face of the note and \$10 for interest when the note comes due, or you may make a non-interest-bearing note for \$1,010, paying the face of the note, \$1,010, when it comes due.

(a) When such a note is issued, the entry will be as follows:

George Strubie.....	\$1,000 -
Interest Cost.....	10 -
Notes Payable.....	\$1,010 -

Note that the Interest Cost item of \$10 is recorded on the books before it is paid, a liability of \$10 for it being included in the face of the note, \$1,010.

The student should make sure that he understands the nature of the Interest Cost item recorded above. At the date the record is made there is no interest used up, the \$10 item being an asset awaiting consumption. Day by day, as the date of maturity approaches, this asset is being consumed. No record is made of this unless it becomes necessary to draw up a balance sheet before the date of maturity of the note. In this case it is necessary to separate the item into the portion which has been consumed and the portion still unconsumed. The first portion is an expense

or capital decrease, the second an asset which will appear on the balance sheet as a deferred or prepaid expense.

(b) When the note is paid the following entry is made:

Notes Payable.....	\$1,010 -
Cash.....	\$1,010 -

Case 4. Selling or Discounting a Non-Interest-Bearing Note Receivable. If a non-interest-bearing note with face value of \$1,000, due in 60 days, is received from Richard Smith, the entry would be:

Notes Receivable.....	\$1,000 -
Richard Smith.....	\$1,000 -

If the note were paid 30 days before it became due or were sold to a bank (discounted), the interest rate being 6%, the "discount" would be \$5 and you would receive \$995 cash. The \$5 is really an interest charge for the use of the money 30 days before the due date of the note. The entry would be as follows:

Cash.....	\$995 -
Interest Cost.....	5 -
Notes Receivable.....	\$1,000 -

Case 5. Prepaying an Interest-Bearing Note Payable. When a note payable is prepaid, that is, paid before it is legally due, the interest calculations must be carefully handled. Suppose that a note for \$1,000 due in 90 days with interest at 6% is paid 30 days before its due date. The transaction may be settled by agreement on either of two bases, viz., (a) the accrued value basis, or (b) the discounted value basis.

(a) A creditor willing to allow prepayment will usually charge the interest accrued to the time of settlement. In this case he will accept \$1,000 in payment of the note and \$10—interest on \$1,000 for 60 days at 6%—in payment of the interest. The entry will be:

Notes Payable.....	\$1,000 -
Interest Cost.....	10 -
Cash.....	\$1,010 -

(b) If, as a matter of agreement, the creditor should be willing to accept the discounted value of the note—the discount rate being 6%—the amount to be paid in settlement will be determined as follows:

Face of note.....	\$1,000 -
Add interest for 90 da. at 6%.....	15 -
Amount due at maturity.....	\$1,015 -
Deduct interest for 30 da. at 6% (discount).. 	5.08
Proceeds—to be paid in full settlement.....	\$1,009.92

The entries will be as follows:

Interest Cost.....	\$9.92
Notes Payable.....	1,000 -
Cash.....	\$1,009.92

Booking Interest Income.—The entries for interest on notes receivable are similar in most respects to those for notes payable. When a note receivable without interest is received, it is the general practice, although perhaps not quite correct theoretically, to enter the note at its face value. A note due in 60 days without interest is, of course, not worth its face value now. From a banker's standpoint it is worth only its discounted value. Thus, \$1,000 due in 60 days without interest, if the discount rate at the bank is 6%, is worth only \$990. However, the almost universal business practice is to record it at its face value, disregarding the discount necessary to determine its true value. Where a business man accepts a non-interest-bearing note, he is in theory making to his customer an allowance of the amount of the discount. However, as he usually expects to keep such notes until they fall due, their acceptance really represents a further

extension of credit to the customer for the time that the note is to run. Banking practice, as distinguished from business practice, almost invariably reckons notes at their true or discounted value.

The title under which to record income received from the use of money lent is Interest Income. Sometimes Interest Earnings or Interest Revenue is used. Several illustrations will be given, involving different situations.

Case 1. Purchasing a Note Receivable Without Interest. Suppose a bank buys a non-interest-bearing note for \$1,000, due in 60 days, the market rate of interest being 6%.

Notes Receivable.....	\$1,000 -
Cash.....	\$990 -
Interest Income.....	10 -

The Interest Income account is a liability account at the date of making this entry, but its status changes from day to day as the bank meets the liability by allowing the use of its money, so that at a later date the exact status of the account can be determined only by analyzing it to see how much of the original liability still exists and how much income has been earned to date.

When the loan matures and is paid, the following entry will be made:

Cash.....	\$1,000 -
Notes Receivable.....	\$1,000 -

At this date the Interest Income account has lost all of its characteristics as a liability account, and records only an increase in capital due to a decrease in a liability.

Case 2. Lending Money on an Interest-Bearing Note Receivable Retained Until Maturity. Suppose you lent Dennis \$1,000 on his 2 months' note at 6%. You would make the following entry:

Notes Receivable.....	\$1,000 -	
Cash.....		\$1,000 -

At the time the loan comes due and is paid by Dennis you will make this entry:

Cash.....	\$1,010 -	
Notes Receivable.....		\$1,000 -
Interest Income.....		10 -

Here, the Interest Income account is a pure earning or income item, as it indicates the increase of capital due to allowing the borrower the use of the money during the 2 months' period.

Case 3. Lending on a Note Receivable with Interest Included in the Face Amount. If a 60-day note is received in payment of a \$1,000 debt, on which interest is to be calculated at the rate of 6%, it might be made out in two ways, either an interest-bearing note for \$1,000 for 60 days at 6% amounting at its due date to \$1,010, or a non-interest-bearing note for \$1,010 for 60 days. The entry to record the latter transaction would be:

Notes Receivable.....	\$1,010 -	
Customer.....		\$1,000 -
Interest Income.....		10 -

At this point the student should pause to consider from the standpoint of the three fundamental classes of accounts—assets, liabilities, and capital—the nature of the above transaction. The interest income at the time it is recorded has not been earned. Day by day as time goes by it will be earned, until at the end of the 60 days it will be fully earned. Therefore, on the date of its record on the books the interest income of \$10 is in the nature of a liability. Were a balance sheet to be drawn up on the day when the \$10 interest income is recorded on the books, that item would be shown among the liabilities as a deferred income item.

If the books are closed some time after the original entry is made, but before the note comes due, the portion of the income

earned to the date of the balance sheet will be treated as an increase in capital, while the portion remaining unearned will be shown as a liability under the head of Deferred Income. Accounting is very exacting and accurate as to the separation of items belonging to two different periods. It is only because, as it were, the business is brought periodically to a full stop and financial condition determined on that date, that it is necessary to make these nice divisions of responsibility or liability of one period to another. When the note is settled, the entry is as follows:

Cash.....	\$1,010 -
Notes Receivable.....	\$1,010 -

Case 4. Buying an Interest-Bearing Note Receivable Before Maturity. The note may be bought on either one or two bases, viz., (a) the accrued value basis, or (b) the discounted value basis.

(a) Suppose you bought from Richard Smith a \$1,000, 90-day, 6% note, 30 days before it is due. At the date of purchase it would have 60 days' accrued interest. You would be willing to pay \$1,010 for it, buying the \$10 accrued interest with the note. The entries to record the transaction would be:

Notes Receivable.....	\$1,000 -
Accrued Assets.....	10 -
Cash.....	\$1,010 -

The student will note that the charge for the accrued interest is made not to the Interest account but to the Accrued Assets account. Such a transaction is often spoken of as the "purchase" of income. This Accrued Assets item will be transferred—either immediately or at the close of the fiscal period—to the Interest Income account, by the following entry:

Interest Income.....	\$10 -
Accrued Assets.....	\$10 -

When this note falls due, you will collect the interest for the entire 90 days, that is, you will receive \$15 interest. Of this \$15, however, you paid at the time you received the note \$10 to Richard Smith who owned the note for 60 days, and is, therefore, entitled to the interest earned during that time. The purchase of Smith's right gives you the right to receive the entire amount of interest when the note comes due. When the note is paid at its due date you will receive \$1,015. Your Interest Income account will then show as follows:

INTEREST INCOME

Accrued Assets.....	\$10 -		Smith's note.....	\$15 -
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The student will now see the reason for transferring Accrued Assets to the Interest Income account as shown above. This \$10 acts as an adjustment or offset to the \$15 credit which will be made in the account when the note is finally paid. The Interest Income shows that income to you for the 30 days which you hold the note is \$5. In making the debit and credit analysis, therefore, of a transaction involving the receipt of an interest-bearing note on which interest has accrued, the student must look forward to what record will be made of the note when paid.

(b) If Smith's note is valued on a discounted basis, the amount you will pay him for it will be the proceeds as usually calculated.

Face of note.....	\$1,000 -
Add 90 days' interest.....	15 -
Amount.....	\$1,015 -
Less 30 days' interest (discount).....	5.08
Proceeds.....	\$1,009.92

The entries for recording it, will, except for the figures, be the same as in (a) above.

Case 5. Allowing a Customer to Prepay His Interest-Bearing Note. Sometimes it is advisable to permit a customer to pay his note before maturity. For example: Suppose you hold Henry Jackson's 90-day note for \$1,000 with interest at 6% and Jackson offers to pay the note 30 days before maturity. The settlement is usually made by agreement on either of two bases, viz., (a) the accrued value basis, or (b) the discounted value basis.

(a) According to the accrued value basis, the entry on your books would be:

Cash.....	\$1,010 -
Notes Receivable.....	\$1,000 -
Interest Income.....	10 -

This indicates the payment of the face of the note \$1,000 and 60 days' interest, \$10, total, \$1,010.

(b) On the discounted value basis, with money at 6%, Jackson would be allowed 30 days' discount at 6% on \$1,015. In this case your entry would be:

Cash.....	\$1,009.92 -
Notes Receivable.....	\$1,000 -
Interest Income.....	9.92

Case 6. Selling an Interest-Bearing Note Receivable. Notes receivable from customers are oftentimes discounted, i.e., sold, at the bank to raise money for carrying on the business. Recording such a transaction must be handled with care. For example: You have Silas Brown's 6 months' note for \$2,400 dated September 10, 1919, with interest at 5% which you discount at the First National Bank on January 10, 1920, at 6%. Discount calculations provide the following data:

- (1) Date of maturity (Sept. 10, 1919 + 6 mo.) = Mar. 10, 1920.
- (2) Term of discount (Jan. 10, to Mar. 10) = 60 da. (February had 29 da. in 1920.)
- (3) Interest on \$2,400 at 5% for 6 mo. = \$60.
- (4) Amount (principal, \$2,400 + int., \$60) = \$2,460.

(5) Discount on \$2,460 at 6% for 60 da. = \$24.60.

(6) Proceeds (amount, \$2,460 - dis., \$24.60) = \$2,435.40.

There are several different ways of recording this transaction. For the present, the following method will be used:

Cash.....	\$2,435.40 -
Notes Receivable.....	\$2,400 -
Interest Income.....	35.40

QUESTIONS

1. Define "interest."
2. Why is it now considered an upright practice to make a charge for lending money?
3. Compare interest and rent.
4. What is the idea back of both the rent and interest charges?
5. What is meant by "interest cost" or "interest expense"? "Interest income"?
6. What effect does length of time money is used have on the interest charge?
7. Explain the standard method of stating the interest charge.
8. When does the interest charge usually begin?
9. Explain "legal rate," "maximum rate," "usury," as applied to interest.
10. Give the laws of your state in regard to interest.
11. When is the interest usually paid:
 - (a) If money is borrowed from a bank?
 - (b) If money is borrowed from a source other than a bank?
12. Does interest cost paid in advance indicate an increase in an asset or a decrease in capital? Explain.
13. When closing the books at the end of a fiscal period, how should you handle interest cost consumed? Not consumed?
14. When interest cost is paid after the use of the money has been enjoyed for a given time, what does it indicate? Explain.
15. (a) If rent is paid after the property has been used, what does it indicate?
 - (b) Compare your answer to Question 15 (a) with your answer to Question 14.
16. What effect does paying for the use of money have on the profits? Explain.

17. Interest cost from the standpoint of the borrower is interest income from the standpoint of the lender of money. Explain.

18. When a bank is paid in advance for lending money, what does its Interest Income account indicate?

19. As time passes what change takes place in the nature of the Interest Income account in Question 18? Explain.

20. When closing the books at the end of a fiscal period, how should you handle interest income earned? Not earned?

21. Name the principal sources through which one may obtain the use of other people's money.

22. Name five ordinary methods employed in obtaining money.

23. How is the date of maturity of notes found if the time is given in months? In days?

24. Explain an easy method for finding the due date if the time is 30 days, or even multiples of 30 days.

25. Explain three methods of finding the time between two dates.

26. Explain the 60-day method of finding the interest.

27. Explain how to use this method when the rate is other than 6%.

28. Explain how the principle involved in the 60-day method may be applied to a 4% rate? 5% rate? $4\frac{1}{2}\%$ rate? 8% rate? Any rate?

29. Explain "interchanging" principal and time.

30. (a) What is meant by "accurate interest"?

(b) How may it be found by the 60-day method?

31. How is the amount due at maturity found?

32. Explain fully what is meant by "discounting notes."

33. Name and explain the eight expressions used in solving discount problems.

34. Is interest cost always booked as a debit? Explain.

35. Compare bank discount with interest cost.

36. Explain and analyze the discounting of a non-interest-bearing note payable.

37. What entries are made: (a) at the time of discount, and (b) at the time of payment of the note? Explain.

38. Explain the borrowing of money on an interest-bearing note not discounted.

39. What entries are made: (a) at the time of borrowing, and (b) at the time of payment of the note? Explain.

40. Explain the borrowing of money on a non-interest-bearing note having interest included in the face of the note.

41. What entries are made: (a) at the time of borrowing, and (b) at the time of payment of the note? Explain fully.

42. Explain the borrowing of money on a non-interest-bearing note receivable.
43. What entries are made: (a) when the note is received, and (b) when the note is discounted? Explain.
44. Explain the method of calculating the amount to be paid when settling a note payable before it becomes due: (a) on an accrued value basis, and (b) on a discounted value basis.
45. What entries are made: (a) in the case of Question 44 (a), and (b) in the case of Question 44(b).
46. Distinguish between the face and true value of a non-interest-bearing note receivable at the time of its receipt.
47. When a business man accepts a non-interest-bearing note receivable is he really extending the credit term? Discuss.
48. What other titles are used for interest income?
49. Explain the purchase of a non-interest-bearing note receivable.
50. What entries are made: (a) at time of purchase, and (b) at time the loan matures? Explain.
51. Explain the loan of money on an interest-bearing note to be retained until maturity.
52. What entries are made: (a) at time of the loan, and (b) when the loan is paid? Explain.
53. Explain the loan of money on a note receivable with interest included in the face.
54. What entries are made: (a) when the note is received, and (b) when it is paid? Explain fully.
55. Explain the purchase of an interest-bearing note receivable before maturity: (a) on an accrued value basis, and (b) on a discounted value basis.
56. What entries are made: (a) for Question 55(a), and (b) for Question 55 (b)? Explain fully.
57. Explain how to find the amount to be paid by a customer who pays his note before it is due: (a) on an accrued value basis, and (b) on a discounted value basis.
58. What entries are made: (a) for Question 57(a), and (b) for Question 57(b)? Explain.
59. Explain discounting an interest-bearing note receivable.
60. What entry is made when the note is discounted?

PROBLEMS

1. Find the interest and the amount due at maturity in each of the following:

	Principal	Time		Rate	
1	\$ 300	a	60 da. (2 mo.)	q	6 %
2	800 -	b	90 da. (3 mo.)	r	5
3	910.40	c	54 da.	s	4
4	385.15	d	27 da.	t	7
5	2,904.12	e	81 da.	u	4 1/2
6	792.35	f	1 yr. 7 mo.	v	3 1/2
7	6,327.92	g	264 da.	w	8
8	150 -	h	30 da. (1 mo.)	x	7 1/2
9	536.50	i	19 da.	y	3
10	72.25	j	120 da. (4 mo.)	z	5 1/2

Note: 1,000 problems may be obtained from the material tabulated above. For example: The principal in No. 1, \$300, may be used in connection with time (a) for each of the 10 rates (q) to (z); and the same principal, \$300, may be used with time (b) for each of the rates (q) to (z). This may be continued until all the rates (q) to (z) have been used with all the times (a) to (j) for each of the number of dollars shown in the Principal column. The solutions should be numbered "1 a q," "1 a r," "1 a s," etc., until z has been used; then number 11 would be number "1 b q"; and 12 would be "1 b r" etc.

2. In each of the following find the date of maturity, interest, amount, term of discount, and proceeds.

	Principal	Date	Time	Interest Rate	Date of Discount	Rate of Discount
1	\$ 600 -	Jan. 5	3 mo.	no	Mar. 6	6%
2	450 -	Jan. 30	6 mo.	no	May 31	6
3	500 -	Mar. 10	4 mo.	6 %	June 10	6
4	376.25	Apr. 6	90 da.	6	June 16	6
5	720.50	Sept. 21	2 mo.	5	Oct. 22	6
6	1,200 -	Nov. 7	60 da.	7	Dec. 16	5
7	278.45	June 8	90 da.	5	Aug. 1	6
8	592.75	July 12	120 da.	4 1/2	Aug. 14	5
9	612.92	Feb. 2	9 mo.	4	May 5	5
10	815.35	Oct. 16	75 da.	6	Nov. 20	5

3. Kenneth Campbell discounted his 60-day non-interest-bearing note for \$500 at the First National Bank, receiving cash therefor.

- (a) Write Campbell's entry when the note was discounted.
- (b) When the note was paid.
- (c) Write the bank's entry when the note was discounted.
- (d) When the note was paid.

4. Paid R. S. King cash for your 60-day interest-bearing note for \$1,200 due today.

- (a) Write your journal entry at date of payment.
- (b) Write King's journal entry at date of payment.

5. Frank Malone lent D. E. Craig \$1,000 on his 4 months' note without interest for \$1,040.

- (a) Give Craig's entry when he issued the note.
- (b) When he paid the note.
- (c) Give Malone's entry when loan was made.
- (d) When he received payment at date of maturity.

6. You own George Burke's 6 months' note for \$800 without interest. You discount the note at the Second National Bank 3 months before maturity at 6%.

- (a) Give your entry when the note was discounted.
- (b) Give the bank's entry when the note was discounted.

7. You sold to the Western Bank, C. F. Warner's 4 months' \$1,000 note with interest at 6%, one month before maturity; discount rate 6%; interest \$30; amount \$1,020; discount \$10.20; proceeds \$1,009.80.

- (a) Write your entry when the note was discounted.
- (b) Write the bank's entry when the note was discounted.
- (c) Write the bank's entry when the note was paid.
- (d) Write Warner's entry when he paid the note at maturity.

8. Two months before maturity you paid John Hardy \$3,263.04 in cash for your 6 months' note for \$3,200 with interest at 6%; rate of discount 6%; interest \$96; discount \$32.96.

- (a) Write your entry when you prepaid your note.
- (b) Write Hardy's entry at the time of prepayment.

9. Harry Rice sent you his check for \$615 in payment of his 5 months' note for \$600 with interest at 6%, due today.

- (a) Write your entry to record payment of the note
- (b) Write Rice's entry at the date of payment.

10. You received from John Fox, to apply on account, his 60-day note for \$1,000 without interest. You allowed him the discount value of the note.

- (a) Write your entry at the date you received the note.
- (b) Write Fox's entry for the same date.
- (c) Write your entry when the note was paid.

11. May 3, Charles Duncan sent to you to apply on account a 90-day interest-bearing note for \$800 dated April 3, signed by Benjamin Rowe. You agreed to take the note at its face value, \$800 plus 30 days' accrued interest, \$4.

- (a) Write your entry on May 3.
- (b) Write Duncan's entry on May 3.
- (c) Write Rowe's entry on July 3 when he paid the note.
- (d) Write your entry on July 3 after receiving payment for the note.
- (e) Show the Interest Income account on your books on July 3.

12. October 16 you paid James Wagner by check \$398 for your \$400, 90-day note without interest, dated August 17. Wagner agreed to accept the discount value for the note.

- (a) Write your entry as of October 16.
- (b) Write Wagner's entry for the same date.

13. October 23 you discounted at the United Trust Company, Henry Anderson's 90-day note for \$1,200 with interest at 6%, dated August 14; interest \$18; discount \$4.06; proceeds \$1,213.94.

- (a) Give your entry on October 23.
- (b) Give United Trust Company's entry on October 23.

CHAPTER XVII

DISCOUNTS—TRADE AND CASH

Purpose of Chapter.—

1. Explanation of trade discounts.
2. Origin and nature of cash discounts.
3. Analysis and recording of sales and purchase discounts.

Definition of Discount.—A **discount** may be defined as a deduction made from a given amount. This may be for the purpose of determining a sales price or the settlement price of a bill or open account.

Trade Discounts.—Some businesses publish catalogues in which a list price is set up for each commodity. This price is not, however, the sales price, which is determined by deducting an amount known as a **trade discount**. For example, the merchant may *list* a commodity at \$500, but allow a trade discount of 10%. The price, therefore, at which he will sell the commodity is \$450 (\$500 less \$50, 10% of \$500, equals \$450). The custom of using trade discounts serves several purposes. It often costs a great deal to issue a catalogue giving full descriptions and prices of all commodities handled by a merchant. Where prices change frequently, the cost of new catalogues to announce price changes would be prohibitive. Out of this condition grew the practice of using a list or basic price in the catalogue and of issuing a "discount sheet" on which, by means of a reference to each article by catalogue number, was scheduled the discount allowed in order to determine the selling price. The cost of discount sheets, containing only catalogue numbers and discount rates, is so small comparatively that by means of new sheets the pur-

chaser can be informed of price changes as soon as they occur, the new sheets giving new discount rates which indicate the new sales price.

It was formerly considered desirable by a wholesaler to keep his prices secret from his competitors. The use of a list price, which without the discount sheet meant nothing, assisted in this.

Trade discounts are used singly or in series. A list price of \$500 may have a single discount of 10%; another list price of \$750 may have a discount series of 33 $\frac{1}{3}$ % and 10%; while a third list of \$900 might have a series of 30%, 10%, and 5%. The list price has no relation to the sales price, the discount rate or rates being the essential connecting link. Were it desired to establish a sales price of \$100, any list price might be taken, provided sufficient discounts were allowed to bring the sales price down to \$100. In the application of a discount series, it is the practice to apply each discount in turn to the reduced price found by applying the previous discount. Thus, when the list is \$100 and the discount series is, say 20, 10, and 10, the use of the first discount rate of 20% leaves a price of \$80. Deducting 10% of this leaves \$72. The final 10% taken from this leaves a price of \$64.80, the selling price. The computation may be made by either of the following methods:

Method 1		Method 2	
\$100 list price		\$100	\$ 80
<u>.80</u> 100% less 20% (1st discount)		<u>.20</u>	Less 8
\$80. 1st reduction		\$ 20.00	\$ 72
<u>.90</u> 100% less 10% (2nd discount)		\$100	<u>.10</u>
\$72. 2nd reduction	Less 20		\$ 7.20
<u>.90</u> 100% less 10% (3rd discount)		\$ 80	\$ 72.00
\$64.80 3rd reduction and sales price		<u>.10</u>	Less 7.20
		\$8.00	<u>\$ 64.80</u>

While a trade discount is seldom, if ever, entered on the account books, it is customary to enter it on the sales invoices.

Here the list price is first set up and the discounts deducted, giving the sales price, or amount for which the customer is charged. This latter is the amount entered on the account books. The practice of indicating sales price by means of a list price and discounts is not universal, some trades making no use of it.

Cash Discounts.—Cash discount is a deduction allowed at the time of the settlement of an account, that is, after the sale has been made, and not before the determination of the sales price. It is common in some lines of business to sell goods with an optional basis for payment. Thus, a merchant may sell goods for \$1,000 on a credit term of 30 days, with an option of 2% off if payment is made within 10 days. If the buyer makes payment any time within 10 days, the seller will accept \$980 (\$1,000 less 2% of \$1,000 equals \$980) in full settlement. This deduction allowed for settlement of a debt earlier than it is legally due is called **cash discount**.

Since cash discount on sales is a matter of agreement between buyer and seller and depends on the time involved, the seller may allow the discount even after the time allowed for taking the discount has elapsed. For example, Allen sells \$500 merchandise to William F. Rogers on September 10, 1920, terms 2/10, n/30. On September 22, 2 days after expiration of the discount privilege, Rogers sends his check for \$490 (\$500 less 2%). According to the agreement Rogers should pay \$500, i.e., although he has paid \$490, this does not settle the debt, because the time during which the discount was allowed has passed. Whether Allen will accept the \$490 as full settlement of the debt now becomes a matter of business policy. Insistence that Rogers pay the full \$500 may lose him Rogers' trade, whereas granting him the additional time may retain it. Abuse of the discount privilege is becoming a serious evil in some trades, and each seller must decide the question for himself.

As mentioned above, trade discount is a deduction allowed before the determination of the sales price of the goods, while

cash discount is a deduction that is allowed after the determination of the sales price and has for its purpose the securing of the settlement of the debt earlier than the full credit term agreed upon by buyer and seller.

From the standpoint of the seller of goods the cash discount which he allows for early settlement of the debt is spoken of as **sales discount**, that is, a discount on sales made by him. From the standpoint of the customer or purchaser the cash discount which he is allowed is spoken of as a **purchase discount** or a **discount on purchases**.

Basic Nature of Sales Discount.—Cash discount is a peculiarity of trade practice in the United States, seldom met with elsewhere. During and at the close of our Civil War, financial conditions were bad and the loss from uncollectible accounts was extremely heavy. In a great many instances goods had to be sold on long credit, because merchants were not able to pay cash for them but had to wait until the goods were sold to make settlement. The sellers of goods then hit upon the device of allowing a discount from the sales price to those buyers who could pay in a shorter time than the full credit term extended to most buyers. The seller could afford to do this because by receiving payment of a debt the loss from uncollectible accounts was materially lessened. The sales discount is, therefore, in the nature of an allowance made for cutting down this loss which would be incurred were the account allowed to run the full credit period. Every business man knows that he is not able to collect all of his accounts. He knows that the longer the account runs, the longer it becomes past due, the less likely is he to collect the full amount. He may lose all of it. Hence, if he can cut down the amount of this loss from uncollectible accounts by offering as an inducement to customers a slight deduction from the amount of their bills if they will make payment earlier than agreed in the sales contract, he can well afford to do so. Furthermore, he secures the use of his funds earlier than he would were customers to take

advantage of the full credit term. To illustrate, if a sale of goods for \$1,000 is made on the basis of a credit term of 30 days, with 2% off if payment is made within 10 days, the seller may have to wait 30 days before he will get the use of the \$1,000 due him. If the customer makes payment within the 10 days, the merchant will have \$980 to use 20 days earlier than he would have had the \$1,000, had the customer elected the other basis of settlement. The \$20 deduction may be looked upon as a payment made or expense incurred by the merchant for two purposes, namely, (1) the prevention of loss from uncollectible accounts, and (2), to a much lesser degree, the use of money earlier than would be possible under the other basis of settlement.

Analysis of Sales Discount.—When charging the customer at the time of a sale on an optional basis, the merchant does not know which basis of settlement the customer will select. Accordingly, the customer is charged with the full amount as determined by the regular credit period. For example, in the case used above where a \$1,000 bill of goods is sold on 30 days' credit with an optional basis of settlement of 2% off within 10 days, the charge to the customer's account would be \$1,000. If the customer pays \$1,000 at the end of 30 days, he is credited with \$1,000 in full settlement of his account. If, however, he pays \$980 within 10 days, he has under the terms of the contract settled his account in full, and his account must also be credited for \$1,000. The cash received in this case is \$980, the deduction being \$20. Record must be made of all these items in order to give the merchant full information as to what took place. When an expense is incurred it is usually settled in cash. Settlement by means of any other asset is, however, equally good. Thus, if a salesman wishes to receive his salary in merchandise instead of in cash, the record would be so made. This would in no way change the expense record, as Salaries account would still be charged. Instead of crediting Cash, however, the Sales account would be credited. In much the same way, if a merchant incurs an expense

stead of deducting his discount, had paid the gross amount, \$1,000, and had received in return \$20 as payment for the service rendered, the true nature of the earning would be more apparent. The fact that the customer when making payment deducts from the face of the bill the amount due him does not alter the nature of the transaction.

Analysis of Purchase Discount.—What has been said above concerning the fundamental nature of the purchase discount transaction gives the basis for making its debit and credit analysis.

The customer settles his liability to the seller in two ways: (1) A portion is settled by cash payment, and (2) the other portion is settled by rendering a service for which the creditor makes an allowance. The student will recognize that this transaction results in a decrease of assets, a decrease of liabilities, and an increase in capital. Case 4, "Increases in Capital," Chapter VI, page 56, shows this, the capital increase being due to the amount by which the liabilities decrease more than the assets. This capital increase, now in the creditor's account, must be transferred to some capital account. This is accomplished by debiting the creditor's account and crediting the income account, Purchase Discount.

Recording Purchase Discount.—With the illustration used above, the entry on the journal of the customer will be as follows:

Frank Munson.....	\$1,000 -	
Cash.....		\$980 -
Purchase Discount.....		20 -

Other methods of booking purchase discount will be explained later. Various account titles, such as Discounts on Purchases, Discounts Earned, Discounts Received, etc., are used. The title, Merchandise Discount, is sometimes used for both sales

and purchase discounts. It is perhaps better to use a title in which the word "purchase" appears, as the nature of the transaction is then apparent. Since the Purchase Discount account is an income account, it must be closed into the Profit and Loss account at the end of the fiscal period.

The journal entry which would be made for this transaction is as follows:

Purchase Discount.....	\$.....	
Profit and Loss.....		\$.....

In showing the item in the profit and loss statement it will be included under the section, Other Income.

Financial Management Section of Profit and Loss Statement.

—After subtracting from the figure of gross profit, the total of the operating expense groups, the item of Other Income will be added to the remainder in order to arrive at the figure of total income for the fiscal period. From this total the Deductions from Income will be taken, as explained on page 282, in order to derive the figure of Net Profit.

The section of a profit and loss statement which is shown on page 282 indicates the form in which items of Interest Cost, Interest Income, Sales Discount, and Purchase Discount are set forth.

Assume that the Sales were \$50,000 and the Cost of the Goods Sold was \$35,000, then the Gross Profit on Sales is \$15,000; from which are deducted Operating Expenses of \$8,000, leaving Operating Profit of \$7,000. The name "Operating Profit" instead of "Net Profit" is given to the remainder after deducting the Operating Expenses from the Gross Profit on Sales, because additional increases and decreases in capital occur before Net Profit results. If the Interest Income is \$47, Interest Cost \$30, Sales Discount \$100, and Purchase Discount \$103, these items will be set up in the profit and loss statement as follows only the new section being here shown in detail:

Operating Profit.....		\$7,000 -
Additions to Income:		
Interest Income.....	\$ 47 -	
Purchase Discount.....	103 -	
Total.....		150 -
Total Income.....		\$7,150 -
Deductions from Income:		
Interest Cost.....	\$ 30 -	
Sales Discount.....	100 -	
Total.....		130 -
Net Profit.....		\$7,020 -

These items compose the financial management section of the profit and loss statement as shown above.

QUESTIONS

1. What do you understand by a "discount"? Illustrate.
2. What is a list price? Of what use is it?
3. How do you find the selling price when the catalogue or list price is known?
4. When a series of discounts is given, how do you calculate the sales price?
5. Distinguish between a trade discount and a cash discount. Illustrate.
6. (a) What is the basic element in sales discount?
(b) Explain the origin of the cash discount practice.
7. What other element besides uncollectible accounts is contained in the sales discount expense?
8. Is cash used in paying for the sales discount expense? Explain fully.
9. How would you record a sales discount transaction? Give an example.
10. In case of a sales discount, how is the credit to the customer's account posted?
11. Under what different titles is a sales discount recorded? Which is preferable?

12. What is a purchase discount? Give an example.
13. Are the basic elements of a purchase discount the same as those of a sales discount?
14. Why then is one an expense and the other an income? Explain fully the nature of the income.
15. Is the purchase discount income received in cash or in some other form of asset?
16. How would you record a purchase discount transaction? Give an example.
17. Give several account titles for purchase discounts. Which is preferable?
18. What journal entry is necessary to close Purchase Discount at the end of the fiscal period?
19. Explain fully the financial management section of the profit and loss statement.
20. Prepare a financial management section for a profit and loss statement, supplying the items and figures.

PROBLEMS

1. June 1, 19—, M. T. Smith sold to L. M. Pate an invoice of goods for \$500, less a 10% trade discount.
 - (a) What was the cost of the goods to Mr. Pate?
 - (b) Give Mr. Pate's journal entry.
 - (c) Give Mr. Smith's journal entry.
2. August 30, 19—, William R. Black sold merchandise to Lewis F. Johnson amounting to \$2,000, less 10% trade discount, on terms 2/10, n/30.
 - (a) Give Black's journal entry August 30.
 - (b) Give Johnson's journal entry August 30.
 - (c) What amount was due September 9, 19—? September 29, 19—?
 - (d) Johnson paid the bill September 8. Give journal entry for Johnson. For Black.
3. An automobile was listed at \$1,800, less a trade discount of 25%, 10%, and 5%.
 - (a) What is the trade price of the car?
 - (b) The series of discounts are equivalent to what single discount?
4. (a) Journalize the following transactions made by Thomas E. Watson, Baltimore, Md.:

June, 19—

1. Paid invoice from Strong and Company for \$350, less 2% cash discount.
4. Purchased merchandise from Wagner and Sons amounting to \$200, less 10% trade discount.
5. Paid Pickering Hardware Company on their invoice of May 26 \$500, less 2% cash discount.
6. Sold merchandise to J. H. Horner amounting to \$600, less 12% trade discount.

(b) Open the necessary accounts and post all items.

(c) Close the Purchase Discount account at the end of the period.

5. (a) Journalize the following transactions made by Harwood Chemical Company, Brooklyn, N. Y.

August, 19—

1. Sold merchandise to Dorb Drug Company amounting to \$900, less 10% trade discount, terms 2/10, n/30.
5. Paid New York Specialty Company \$1,200, less 2% cash discount.
7. Purchased merchandise from Brooklyn Sales Company, amounting to \$2,500, less 15% trade discount, terms 2/10, n/60.
10. Received cash from Dorb Drug Company for invoice of August 1, less discount.

(b) Open the necessary accounts and post all items.

(c) Close the Sales Discount and Purchase Discount accounts.

6. The following accounts were settled according to the highest discount terms.

(a) Write the necessary journal entries to complete each of the accounts marked X, Y, and Z.

(b) Post the sales and purchase discount items and close these accounts.

X

GILBERT TERHUNE

[illegible]

Y

RICHARD HARPER

19—					19—				
Oct.	3	1/30, n/60	J 18	636 15	Oct.	20	Ret'd from bill of		
	17	2/10, n/30	J 27	450 —			10/17	J 30	150 —
	24	4/15, 1/40, n/60	J 36	384 63					
	30	net	J 40	215 84					

Z

SETH B. ST. JOHN

19—					19—				
July	10	Ret'd from in-			July	3	5/10, 2/30, n/60	J 14	3,000 —
		voice 7/3	J 18	500 —		13	2/20, n/30	J 21	4,400 —
						18	net	J 27	970 —
						27	3/15, 1/30, n/60	J 34	2,530 74

7. John Anderson's bookkeeper began making the profit and loss statement for the year ended July 31, 19—, but did not complete it. From the following information you are asked to complete the statement: Gross Profit on Sales \$39,600; Operating Expenses \$8,460; Sales Discount \$485; Interest Income \$160; Purchase Discount \$540; Interest Cost \$70.

8. A section of a trial balance contained the following:

Sales Discount.....	\$340 50	
Interest Income.....		\$100 —
Expense.....	74 68	
Rent.....	300 —	
Salaries.....	743 75	
Interest Cost.....	52 05	
Purchase Discount.....		278 90

Inventories: Rent paid in advance \$100; expense items unconsumed \$30; salaries of clerk accrued \$75.

- Set up in skeleton equation form.
- Transfer to Profit and Loss account in skeleton form.
- Write the necessary closing journal entries.
- Show the arrangement of the items in the profit and loss statement.

9.

September, 19—

1. Milton Strong began business with the following assets and liabilities: cash \$3,000; stock of merchandise \$4,000; furniture and fixtures \$1,200; accounts receivable as follows: John Atkin \$240; Charles Willis \$150; C. E. Keller \$200. He owed on account to Frank Allen, \$300; Ralph Hall \$400.
2. Paid Home Real Estate Company by check \$200 for rent of store for the month.
3. Charles Willis sent a check for \$147 in full payment for his account of the 1st, \$150, less 2% discount.
4. Sold to John Atkin, 2/10, n/30, bill of merchandise \$1,200.
5. Bought from Frank Allen, 2/10, n/30, invoice of merchandise \$200.
6. Paid Ralph Hall by check \$392 in full payment for account owed him on the 1st, \$400, less 2% discount.
8. Received from C. E. Keller check in full of his account, \$200, less 3%.
10. Bought from Ralph Hall, 3/10, n/30, invoice of merchandise \$500.
12. Sold to C. E. Keller, 2/10, n/30, merchandise \$1,500.
14. Received check from John Atkin for sale of the 4th, less 2%.
15. Sent Frank Allen check for invoice of the 5th, less 2%.
20. Paid cash for various expenses, \$300.

(a) Journalize above transactions.

(b) Post and obtain a trial balance.

(c) Prepare a balance sheet as of September 20.

(d) Prepare a profit and loss statement, for the 20 days ended September 20.

(e) Close the ledger by journal entries.

(f) Prepare post-closing trial balance.

Additional information as of September 20:

Merchandise inventory	\$3,200
Rent paid in advance	65
Expense items consumed	200
Owed to William Ross, clerk, for salary	20

10.

March, 19—

1. Harold Hudson began business with the following assets and liabilities: cash \$4,000; merchandise \$3,000; accounts against Clyde Mullen \$1,000, and B. A. Butler \$800; account in favor of Daniel Drew \$2,000; notes payable \$1,500, in favor of John Adam

- dated today for 30 days with interest at 6%; furniture and fixtures \$1,500. Sold merchandise, \$2,000 to H. R. Bradford for his \$2,000 note dated today, with interest at 6%.
2. Sold \$1,200 in merchandise to George Chatfield, terms 2/10, n/30. Bought from Adam Bede, 3/5, n/30, merchandise \$2,000. Received check from Clyde Mullen in full for his account, less 2%.
 7. Paid Adam Bede by check \$1,940 for invoice of the 2d, less 3%. Sold to Clyde Mullen merchandise \$1,400, terms 2/20, n/60.
 12. Received check from George Chatfield for sale of the 2d, less 2%.
 15. Paid Simpson and Company in cash for rent of store for one-half month to March 15, \$125.
 20. B. A. Butler gave us his check for \$776 in full of account, less 3%.
 22. Paid cash for miscellaneous expenses \$400.
 27. Received check from Clyde Mullen for sale of the 7th, less 2%.
 31. Gave John Adam our check for \$1,507.50 in payment of our note of the 1st, \$1,500 and 30 days' interest at 6%, \$7.50.

- (a) Journalize.
- (b) Post and obtain a trial balance.
- (c) Prepare a balance sheet as of March 31, 19—.
- (d) Prepare a profit and loss statement.
- (e) Close the ledger by journal entries.
- (f) Prepare a post-closing trial balance.

Additional information, March 31, 19—:

Merchandise inventory	\$1,700
Expense items consumed	300
Furniture and fixtures, depreciation	1%

Accruals as follows:

Interest on Bradford's note for 30 days at 6%.	
Rent owed to Simpson and Company for 1/2 month to March 31	\$125

11. (a) Record the information contained in the following trial balance in ledger form.
- (b) Journalize the additional transactions.
- (c) Post and prepare a trial balance.
- (d) Prepare a balance sheet as of June 30, 19—.
- (e) Prepare a profit and loss statement for the 6 months ended June 30, 19—.
- (f) Write adjusting and closing journal entries.
- (g) Prepare post-closing trial balance.

F. O. GAFFNEY, TRIAL BALANCE, MAY 31, 19—

Cash.....	\$ 2,700	—		
Merchandise Inventory 1/1/—.....	2,000	—		
Notes Receivable.....	2,500	—		
Alva Barber.....	240	—		
Hugh Mc Vean.....	260	—		
Furniture and Fixtures.....	1,000	—		
Peter Vincent.....			300	—
Lucas Smith and Company.....			700	—
Notes Payable.....			1,500	—
F. O. Gaffney, Drawing.....	210	—		
F. O. Gaffney, Capital.....			6,000	—
Merchandise Purchases.....	6,000	—		
Merchandise Sales.....			\$ 7,000	—
Rent.....	250	—		
Salaries.....	300	—		
Expense.....	170	—		
Sales Discount.....	400	—		
Interest Cost.....	90	—		
Interest Income.....			120	—
Purchase Discount.....			500	—
	<u>\$16,120</u>	—	<u>\$16,120</u>	—

Additional transactions:

June, 19—

1. Sold to Alva Barber, 2/10, n/30, bill of goods \$800. Received check from Hugh McVean for his account, \$260, less 3%.
4. Paid Herman Wright for my 2 months' note of April 4 with interest at 6%; face of note \$500; interest \$5.
8. Bought merchandise, on account, 3/10, n/30, from Peter Vincent \$600.
11. Alva Barber sent check for bill of the 1st, less 2%. Sold merchandise for cash \$400.
14. Proprietor withdrew for personal use cash \$50, and merchandise \$60.
17. Sent Peter Vincent check for invoice of the 8th, less 3%. Paid Marvin Safe Company cash for office safe \$300.

24. Received check for \$1,010 from Elmer Ingalls for his 60-day note of April 25 for \$1,000 with interest at 6%, due today
25. Paid cash to Kennedy and Company for stationery and supplies for use in the store \$35.
30. Received from Alva Barber his 30-day note with interest at 6% for \$100 to apply on account. Sold merchandise to Hugh McVean \$500, terms 2/15, n/30.

Inventories, etc., June 30, 19—

Merchandise on hand.....	\$2,300
Depreciation of furniture and fixtures.....	5% for the 6 months
Expense, supplies on hand.....	\$ 50

Accruals:

Owed to Martin Kelly rent for 1 mo. to June 30.....	\$50
Owed to Charles White for services as clerk.....	60
Interest accumulated on notes payable.....	20
Interest accumulated on notes receivable.....	15

12. The following transactions are a continuation of Problem 11 and illustrate the treatment of accruals after payment.

July, 19—

1. Gave Lucas Smith and Company our 30-day note with interest at 6% for \$500 to apply on account.
5. Bought \$900 in merchandise, terms 3/15, n/30, from Peter Vincent. Paid Martin Kelly cash for rent for the months of June, July, and August, \$150.
8. Sold merchandise \$1,200, terms 2/10, n/30, to Alva Barber.
15. Hugh, McVean sent check for sale of June 30, \$500, less 2%. Paid Charles White \$75 in cash for services as clerk to July 12.
20. Gave Peter Vincent check for \$873 in payment of invoice of the 5th, less 3%. Received check for \$1,176 from Alva Barber for sale of the 8th, less 2%.
26. Received check for \$1,522 from Philip Knox in payment of his note \$1,500 and accumulated interest \$22. This includes the interest accrued on notes receivable to June 30.
29. Paid John Malone \$1,025 for my note of \$1,000 due today. The \$25 includes the interest accrued on notes payable to June 30.
30. Received check from Alva Barber in payment for his 30-day interest-bearing note dated June 30.
31. Paid Lucas Smith and Company by check for our 30-day interest-bearing note of July 1.

Additional information July 31, 19—:

Merchandise on hand.....	\$2,500
Rent paid in advance.....	50
Owed to Charles White for services as clerk.....	40

- (a) Journalize the July transactions.
- (b) Post and obtain a trial balance.
- (c) Prepare statements.
- (d) Write the adjusting and closing journal entries.
- (e) Prepare post-closing trial balance.

CHAPTER XVIII

LABOR-SAVING METHODS—THE PURCHASE JOURNAL

Purpose of Chapter.—

1. Grouping transactions into purchases, sales, and cash.
2. Analysis and group journalizing of purchases.
3. Forms and operation of purchase journals.

Grouping Similar Transactions.—When recording transactions, the necessity of making a correct debit and credit analysis has been emphasized in order properly to record their effect upon assets, liabilities, and capital. This is a fundamental requirement of good accounting.

The student's attention is now called to a different kind of analysis or grouping of business transactions. It will be noticed that they can be grouped into classes in accordance with the kind of transaction involved. Here the basis is not that of the debit and credit analysis of the transaction, but of the name or kind of asset involved in the transaction. There are many different kinds of business, and the bookkeeping record best adapted to one business may not be at all suited to another business. What is said here is applicable to the trading business, that is, retail or wholesale stores as distinguished from manufacturing plants and professional businesses.

In the trading business the energies of the proprietor are devoted to buying and selling merchandise, this being the main activity. Whatever instrumentalities help to bring this about must have the careful attention of the owner if he would be successful. His business must be so organized as to bring about the best results. He will have a highly organized delivery depart-

ment because that helps his sales; he will have a well-developed credit and collection department so that he may know to whom he can extend credit without undue loss from uncollectible accounts. He will maintain an efficient buying force to purchase his stock-in-trade in the best markets and of the best quality suited to his needs.

A merchant must also have cash or credit before he can buy goods. After the business is under way he must maintain a continual inflow of cash in order to meet expenses and purchase more stock. Therefore the receipt and disbursement of cash constitute a large and important phase of the transactions of a business.

It is thus seen that the majority of transactions are concerned with:

1. The purchase of merchandise.
2. The sale of merchandise.
3. The receipt of cash.
4. The expenditure of cash.

The Purchase Transaction.—In a broad sense everything a merchant buys may be called a “purchase.” He must buy his store equipment, his delivery equipment, and the services of salesmen and clerks. In some businesses whatever is bought, whether stock-in-trade, real estate, machinery, furniture and fixtures, services of all sorts, the rental of a place of business, the buying of insurance—everything of this sort—is spoken of broadly as a “purchase.” In this sense all of these transactions may be spoken of as “purchase transactions.” The term **purchase** will, however, be restricted here to the buying of merchandise for sale. The merchant must purchase stock-in-trade before he can begin business, and practically all his transactions may be said to be concerned primarily with the buying and selling of some kind of commodity, from which a profit arises.

By **stock-in-trade** is meant the merchandise upon the sale of which the main endeavor of the merchant is centered. What

constitutes stock-in-trade for one business may represent something entirely different in another business. In the furniture business, for example, stock-in-trade may be office furniture of various kinds. In the dry-goods business whatever office furniture the business may possess will be classed, not as merchandise, but as office furniture and fixtures. The student must therefore keep clearly in mind the particular kind of stock-in-trade being dealt in by a given business.

A clear distinction should also be drawn between stock-in-trade and what are sometimes called "expense supplies." In every business supplies of various kinds are bought which are necessary for the efficient conduct of the business. For example, brooms, dust-pans, and other cleaning agencies must be purchased continually, but they are not bought for sale and therefore should never be classed as purchases of stock-in-trade. The same applies to postage stamps, stationery, wrapping-paper, twine, packing boxes and cases, and similar items. All such items should not be classed as purchases, the term "purchase" being limited strictly to the purchase of stock-in-trade.

The Purchase Transaction Analyzed.—No matter where the merchant may secure his stock-in-trade, whether from the manufacturer, wholesaler, the jobber, or even at an auction-room, if the purchase is of goods for sale, it will be classified on his books as a purchase transaction.

Purchases may be made on two general bases: cash, or credit. In the case of of a cash purchase, the transaction involves a simple exchange of one kind of asset for another. So far as the total assets are concerned, the merchant has the same amount after the purchase as before. The form of his assets is, however, different, and it is this change of form which the account books must reflect. Instead of having a given amount of cash he has less cash, but more merchandise. In the case of stock-in-trade purchased on credit, the merchant will have a larger amount of assets, because he has not given any asset in exchange for the

stock-in-trade purchased. He has, however, assumed a liability for the amount of his purchase. Thus, while the assets have been increased there has been a like increase in the liabilities, and the difference between total assets and liabilities will therefore remain exactly the same. By reference to the fundamental equation, $\text{Assets} - \text{Liabilities} = \text{Capital}$, the student will see that there has been no change of capital involved in the purchase either for cash or on credit.

Journalizing Transactions by Groups.—After viewing the average run of transactions in a business for a few days or weeks, the student will realize that a great deal of effort is expended in recording many similar transactions, and that much time can be saved by sorting the transactions during a given day and waiting until the end of the day before recording them on his account records. Today practically every business is organized so as to make this sorting easy.

The student has noticed the use of the sales ticket whenever a sale is made, or the use of the cash register by means of which a record is made of all receipts of cash. Similarly there are tickets or invoices at the time goods are received or purchased. One of the chief purposes of these various useful devices is to classify the transactions occurring during the day. After sorting, the debit and credit record of a group can be made by one entry instead of a great number of entries. This is called a **compound entry** because it is composed of a number of different parts; there are a number of debits to offset one or more credits.

To illustrate, assume that the following purchases of goods have occurred during a day: From John T. Smith \$300; from T. J. Jenkins \$500; from R. W. Watson \$750; from Jones and Campbell \$1,000; from Eagle Merchandise Company \$250. For each of these the debit and credit analysis should be a debit to Purchases account and a credit to the seller of the goods. Were the transactions recorded separately there would be five separate entries, as follows:

Purchases.....	\$ 300 -	
John T. Smith.....		\$ 300 -
Purchases.....	500 -	
T. J. Jenkins.....		500 -
Purchases.....	750 -	
R. W. Watson.....		750 -
Purchases.....	1,000 -	
Jones and Campbell.....		1,000 -
Purchases.....	250 -	
Eagle Merchandise Company.....		250 -

As these transactions are all of the same sort, we may record them by setting up one debit to Purchases for the entire amount and showing credits to each of the individual creditors, as follows:

Purchases.....	\$2,800 -	
John T. Smith.....		\$300 -
T. J. Jenkins.....		500 -
R. W. Watson.....		750 -
Jones and Campbell.....		1,000 -
Eagle Merchandise Company.....		250 -

A saving has been made not only in the amount of space required for the record, but also in the fact that all like transactions have been thrown together in a group for debit and credit analysis.

The Purchase Journal—Old Form.—The student has seen the way in which transactions may be grouped in accordance with the nature of the transaction. He should appreciate that there is a distinct labor-saving in this use of the compound entry to bring on the books a whole group of transactions. It is carrying this idea one degree further to set aside a special book for the record of each of these groups of transactions. In the case of purchases, such a book would be called a **purchase journal**, and absolutely nothing but purchases of merchandise would be recorded in it. Through the use of this separate purchase

journal it will no longer be necessary to bring onto the journal the entries for this group of transactions.

Inasmuch as every purchase transaction results in a debit to Purchases and a credit to the seller, or creditor, the debit item may readily be understood and so need not be stated for each purchase since nothing but purchase transactions are recorded in the purchase journal. There is therefore no need of repeating the debit each time the record of a transaction is made. This is spoken of as a short-hand or abbreviated method, where one of the items of the transaction is suppressed, but can always be readily implied from the name of the journal in which the transactions are recorded. The practice is, however, to bring the unstated items formally onto the journal (i.e., the journal entry is completed) at the time the full record is transferred to the ledger.

The Purchase Journal Record.—The purchase journal, Form 7(a), is merely a device for making a group entry. It has a more or less standardized form and some peculiarities as to its use, but fundamentally it is a labor-saving device.

In its simple form it does not differ as to rulings from the journal with which the student is already familiar. In the use made of the columns there are some differences to be noted, however.

The two columns on the extreme left are the date columns. The wide column is used for a showing of the debit and credit items. The method used in the general journal whereby the debits and credits are shown through the use of margins is not followed here. Margins have no meaning in the purchase journal. The name of the creditor is set up first, close against the date column, followed by whatever explanatory matter may be deemed necessary, usually the address or terms. The first money column is used as an item or detail column, the second money column indicating the total amount of the purchase transaction. The ledger folio column has the same use as in all other journals,

namely, that of a cross-index between the journal and the ledger.

Reference to Form 7(a) on page 299 will make this clear. Stated in another way, the credit of each transaction is set up as the transaction occurs, the debit being held in suspense until such time as it is deemed necessary to show it. At that time the debit to Purchases is set up, the amount being the total of all the credits previously set up. It will thus be seen that the principle of the group entry has been followed, although the manner of making the actual entry differs somewhat from that shown above.

The student must keep clearly in mind two things with regard to entries on the purchase journal: (1) When making day-to-day entries only the credit of each transaction is set up. (2) At the close of the month, or week, the debit side of all of the month's credit entries is set up, the amount being the sum total of the credits. The purchase journal is therefore, when completely written up, as much of a debit and credit journal as any other journal. Of course, the debit and credit equilibrium of all journals is a fundamental of bookkeeping.

To illustrate the form and use of the purchase journal, the following transactions will be shown, first, as they would be recorded in the general journal, and, second, as they would be recorded in the purchase journal.

Purchases were made by an auto sales agency during the month of February, 19—, as follows:

February 1. Johnson, Brown Company:

2 Model M touring cars at \$3,000 each.

1 Truck \$5,000, terms of sale being 2% off from the billed price if payment is made within 10 days, but the full or net amount must be paid within 30 days (these terms of sale are usually written as follows: 2/10, n/30).

Brackett and Hough:

Auto repair parts, \$1,000, terms of sale being 60 days credit (expressed as net 60, i.e., n/60).

PURCHASE JOURNAL

19—									
Feb.	1	Johnson, Brown Co., Flint, Mich., 2/10.							
		n/30:	22						
	2	Model M Touring Cars @ \$3,000		6,000	—				
	1	Truck		5,000	—		11,000	—	
	1	Brackett & Hough, Chicago, Ill., n/60:	23						
		Auto repair parts					1,000	—	
	3	The Big 4 Truck Co., Detroit, Mich., n/10:	24						
	1	Model A Truck		3,000	—				
	2	" C Trucks @ \$4,000		8,000	—		11,000	—	
	29	The Locomotive Co., Phila., Pa., 2/10.							
		n/30:	25						
	1	Sedan		2,500	—				
	1	Touring 5-passenger		2,000	—				
	2	Trucks @ \$3,500		7,000	—		11,500	—	
	29	Merchandise Purchases, Dr.	14				34,500	—	

Form 7. (a) Purchase Journal—Old Form

COMMENTS. Note that the terms of purchase, as in the purchase from the Johnson, Brown Company, immediately follow the name of the creditor on the same line, while the other explanatory matter is shown on the following lines, a uniform margin being maintained. The first money column shows the detailed amounts, while the second money column shows the total. The money columns do not have the debit and credit significance that attaches to them in the general journal. At the close of the month when the debit item, Merchandise Purchases, is set up it is customary to write the term "Dr." after "Merchandise Purchases" because in this journal the distinction between the debit and the credit elements is not made by means of margins.

Note carefully the way in which the purchase journal is ruled.

The total amount for each purchase is extended on the line of the last item shown in the detail column. At the close of the month the single line indicating totals extends across both money columns, while the double lines which indicate the separation of the February transactions from those of the following month extend through the date columns, ledger folio, and the two money columns. The student should learn these matters of form as rapidly as possible.

Posting the Purchase Journal.—In order to have the accounts with creditors show the true status of all claims against the business at all times, transactions with these creditors must be entered in their respective accounts as soon as possible after they take place. It therefore becomes necessary to post the purchase journal daily. Inasmuch, however, as only the credit side of each transaction is shown at the time of the transaction—the debit item being suppressed until the end of the month—only the credit items will be posted from day to day from the purchase journal.

This brings about a lack of equilibrium in the ledger because until the debit item has been posted a trial balance could not be taken. At the end of the month, however, when the debit is posted to Merchandise Purchases, the ledger will be brought into equilibrium.

In making these journal postings the folio reference to show the ledger page on which the account appears should be entered in the purchase journal. In the ledger account there will be shown in the folio column for each item the letter "P" and the page number of the purchase journal from which the item has been transferred.

When the purchase journal is used the Merchandise Purchases account will show in one amount the total of the purchases for the week or month instead of the individual items. The student should note the change from J to P in the initial of the book of original entry.

MERCHANDISE PURCHASES

(Page 14)

[illegible]

Purchase Journal—New Form.—In another form of purchase journal (see Form 7(b)) all reference to the articles purchased is omitted. This condenses the record and results in a great saving of time and space. It is advisable to number each invoice consecutively and enter this number in the purchase journal, after which the invoice may be filed numerically or alphabetically.

<i>Date</i>	<i>Inv No</i>	<i>Name</i>	<i>Address</i>	<i>Terms</i>	<i>F</i>	<i>Amount</i>
<i>Feb 1</i>	<i>1</i>	<i>Johnson Brown Co</i>	<i>Pink Mich</i>	<i>2/10. n/30</i>		<i>11000—</i>
<i>1</i>	<i>2</i>	<i>Bracchetti & Hough</i>	<i>Chicago Ill</i>	<i>n/60</i>		<i>1000—</i>
<i>3</i>	<i>3</i>	<i>The Biggs Truck Co.</i>	<i>Detroit Mich</i>	<i>n/10</i>		<i>11000—</i>
<i>29</i>	<i>4</i>	<i>The Locomotive Co.</i>	<i>Phila. Pa.</i>	<i>2/10. n/30</i>		<i>11500—</i>
<i>29</i>		<i>Madse Purchases Dr.</i>				<i>34500—</i>

Form 7. (b) Purchase Journal—New Form

The standard journal ruling can be adapted to this type of purchase journal by entering the amount of the invoice in the

last money column and writing the headings as indicated. The folio column occupies the cents column of the left money column, the rest of which together with the regular folio column comprises the terms column.

Volume of Business Done with Each Creditor.—In the case of a cash purchase of merchandise the debit and credit analysis results in a debit to Purchases account and a credit to Cash account. It is desirable in some businesses, for the purpose of securing full information concerning the volume of business done with a given creditor, to set up on the books an account with every creditor for merchandise bought, whether payment is made immediately in cash or at a future date. Therefore, for the sake of establishing thoroughly the underlying principles, we shall in the examples given show the creditor's account even though it may be settled immediately by the payment of cash. This method of recording purchases is not a universal practice, however. Assume that a purchase from John B. Garvin was made for cash. A full general journal entry setting up Garvin's account would be as follows:

June 10, 19—

Merchandise Purchases	\$3,000 -	
John B. Garvin		\$3,000 -

This will be immediately followed by the next entry:

June 10, 19—

John B. Garvin	\$3,000 -	
Cash		\$3,000 -

Garvin's account in the ledger would appear as follows:

JOHN B. GARVIN

19— June 10 J 6 3,000 -	19— June 10 J '6 3,000 -	
--	---	--

As Garvin's account has been both credited and debited with the same amount, there is no balance in it. Being on the books, however, it will indicate to the merchant the volume of business he has done with Garvin. The net effect of the two entries has been to debit Purchases and credit Cash, just as if the transaction had been originally entered as:

Merchandise Purchases.....	\$3,000 -
Cash.....	\$3,000 -

While this latter method saves time, the longer method consisting of the two entries is the one which will be followed in the future. The first of the two entries required by the longer method will not, however, be made exactly as shown in the above explanation. Instead of entering in the general journal the debit to Merchandise Purchases and the credit to the seller—in this case John B. Garvin—the transaction will be recorded in the purchase journal, which provides the debit to Purchases and the credits to the individual creditors' accounts. The second entry—the debit to the seller and the credit to Cash—whether made at a future date or at the time of purchase, will, of course, be made in the general journal, just as shown in the example.

Advantages of the Purchase Journal.—Some advantages must result from the use of special journals, otherwise they would not form part of the accounting system. The advantages of the purchase journal are summarized below.

1. Great saving of time and space in recording, all purchases being entered in condensed form, one line to each purchase.
2. Only one more than half the former number of postings required, one posting being made for the total debits for a week or a month.
3. Less chance of errors in posting, since fewer items are transferred.

4. Much space saved in the Purchase account in the ledger, as twelve postings may be sufficient for a year's work where formerly hundreds of debits were necessary.
5. Assists in the subdivision of labor. Two persons can work at the same time—one in the general journal and another in the purchase journal.
6. More convenient to obtain information in regard to a particular purchase, especially if entered numerically, because all purchases are in one journal.

QUESTIONS

1. What is meant by the "analysis" of a business transaction?
2. Name the four important groups into which the transactions of a trading business may be divided.
3. Explain the meaning of "purchase" in the broad sense.
4. What is meant by "stock-in-trade"?
5. How do you determine whether a purchase is stock-in-trade or an expense item?
6. What is meant by "journalizing transactions by groups"?
7. What is a "purchase journal"?
8. (a) Which item is suppressed in a day-to-day record of transactions in a purchase journal? Why?
(b) When is the journal entry completed? How?
9. Give the rulings of the first form of purchase journal.
10. Explain the use of the money columns of the purchase journal.
11. (a) How is a purchase journal summarized?
(b) How is it ruled up or closed at the end of the month?
12. (a) Explain the posting from a purchase journal.
(b) When are the credit items posted? The debit items?
13. Should a purchase of furniture for use in the office be entered in the purchase journal? Why?
14. Give the ruling for the second form of purchase journal.
15. How may the standard form of journal ruling be adapted to use for this journal?
16. How may full information concerning the volume of business done with each creditor be obtained?
17. Why is it desirable to make two entries for a cash purchase when the purchase journal is used?
18. State the advantages of using a purchase journal.

PROBLEMS

1. (a) On a sheet of journal paper write up a purchase journal for the following transactions of a wholesale grain business.

June, 19—

3. Bought from Albers Brothers Milling Company 20 bu. wheat at \$1.75, terms 2/10, n/30.
5. Bought from Armour Grain Company, 10 bu. oats at 51c., terms 2/10, n/30.
12. Bought from Merchants Grain Company 75 bu. corn at 85c., terms n/60.
15. Bought from Armour Grain Company 10 bu. barley at 90c., 200 bu. wheat at \$1.70, terms n/30.

(b) Summarize and rule the purchase journal.

(c) Using one-half sheet of ledger paper, post the purchase journal.

2. (a) Record the following transactions in a purchase journal for a grocery business.

July, 19—

1. Bought from Reese Brothers, on account:
 - 50 lb. Singapore pepper at 13c.
 - 1,000 " fine granulated sugar at 5c.
 - 100 " Japan tea at 20c.
 - 100 " Hyson tea at 30c.
3. Bought from Kent Grocery Stores, terms 2/10, n/30:
 - 500 lb. sugar at 5c.
 - 100 " 7 Rio coffee at 7c.
7. Bought from Overbeck Brothers for cash:
 - 25 lb. tobacco at 18c.
26. Bought from Jewell Grocery Company, terms 2/10, n/30:
 - 1,000 lb. sugar at 5½c.
 - 300 " 7 Rio coffee at 8c.
 - 50 " tea at 25c.
31. Bought from R. M. Nelson 30 doz. eggs at 27c., terms n/60.

(b) Summarize the purchase journal.

(c) Open the necessary accounts and post from the purchase journal.

3. (a) Record the following transactions for a jewelry business. Use a general journal and a purchase journal.

October, 19—

5. Bought from Lieberman and Friedman, terms n/30:
 - 10 Brooches at \$50 each.
 - 10 Brooches at \$15 each.
 - 20 Bracelets at \$20 each.
 - 15 Diamond stones at \$195 each.
 - 12 Lavalieres at \$35 each.
7. Bought from Palmer Jewelry Company, terms n/10, 3 doz. watches of various kinds, total bill \$1,400.
15. Bought from Carpenter Brothers, on account, furniture and fixtures for office use \$1,200.
26. Bought from Forest and Giles, for cash, boxes and wrapping material for store use \$225.
27. Bought from Palmer Jewelry Company a bill of merchandise amounting to \$2,200, terms 2/10, n/30.
31. Bought postage stamps for office use \$20 cash.

(b) Summarize the purchase journal.

(c) Post from both journals.

4. (a) Write up the following transactions for a merchant dealing in ladies' suits and dresses. Use a general journal and a purchase journal.

August, 19—

1. Bought from Matthews Clothes Shop a bill of merchandise amounting to \$9,000, terms 2/10, n/30.
5. Bought from Madison Clothes Company the following bill of goods, terms 2/10, n/30:
 - 25 Serge dresses at \$35 each.
 - 25 Taffeta dresses at \$45 each.
 - 12 Coats at \$55 each.
 - 12 Coats at \$30 each.
 - 12 Coats at \$65 each.
7. Bought from Kaufman Brothers and Company, terms n/60:
 - 4 doz. Waists at \$4 each.
 - 4 doz. Waists at \$6 each.
 - 2 doz. Waists at \$12 each.
10. Bought from Matthews Clothes Shop, for cash, a bill of merchandise amounting to \$2,500.
14. Paid Madison Clothes Company by check for invoice of the 5th, less 2%.
16. Bought from Overland Motor Car Company one delivery car for use in the business \$1,400, terms 6-mo. note for \$1,000, and cash \$400.

22. Paid clerks' salaries in cash \$210.
 31. Bought from Kaufman Brothers and Company merchandise amounting to \$750, terms 2/10, n/30.
- (b) Summarize and rule the purchase journal.
(c) Post from both journals.

CHAPTER XIX

THE SALES JOURNAL

Purpose of Chapter.—

1. Principle of sales analysis by groups.
2. Form and operation of sales journals.

The Sales Transaction Analyzed.—Sales of stock-in-trade are made on two bases: (1) for credit, and (2) for cash. When credit is granted a customer, payment for the goods is deferred until a later date. Every well-ordered business has a more or less uniform credit period. Thus, some merchants sell goods on 30 days' time. There is a tacit agreement that the customer will make payment some time within the 30-day period. Often two or more bases of settlement are offered the customer. He may pay the amount of the invoice at or before the end of the full credit term granted, or he may take off a discount for earlier payment and so not have to pay the full amount of the invoice. For example, the terms, 2/10, n/30, in connection with a \$1,000 sale would give the customer the option of paying \$980 some time within the 10-day period and within the 30-day credit limit. When a sale is made for cash, payment is made at the time of the sale, although in many businesses it is the custom to pay within 10 days when the terms are stated as "cash."

The analysis of the debit and credit items of a sales transaction discloses a difference between the sales transaction and the purchase transaction. Inasmuch as it is through the sale of stock-in-trade that the merchant makes his profit, we have not merely the exchange of one asset for another, but also an increase in capital. Were the commodity sold at the cost price, there would be simply a change of the asset, Merchandise, for some

other asset, such as Cash, Accounts Receivable, or Notes Receivable. Normally, however, goods must be sold for more than they cost, else there is no incentive for carrying on business. Accordingly, we may analyze a sales transaction as resulting in an increase in the assets, Cash, Accounts Receivable, or Notes Receivable, a decrease in the asset, Merchandise, and an increase in capital. At the time of each sale the merchant may not know exactly the amount of decrease in his stock or of increase in his capital. This does not in any way void the principle involved. The amount of the credit entry in the Sales account includes not only decrease in the asset, Merchandise, but also increase in capital. It is only at the end of the fiscal period, by means of physical inventory, that the amount of the cost of the goods sold can be determined, and the Sales account broken into its two parts, one of which indicates the cost price of the goods sold, the other the temporary increase in capital. From this increase in capital must be deducted the expenses of the business.

Journalizing Sales Transactions by Groups.—A sale of merchandise on account may be recorded as a debit to the customer, by name, and a credit to the Sales account. The debit to the customer's account indicates the increase in the asset, Accounts Receivable. The credit to the Sales account is a mixed item indicating: (1) the decrease in the asset, Merchandise, and (2) the increase in capital, i.e., profit. The excess of the increase in the claim against the customer over the decrease in the asset, Merchandise, measures the profit. To illustrate, suppose that a sale of merchandise was made to John R. Barry for \$80. This would be entered in the general journal as follows:

John R. Barry	\$80 -
Merchandise Sales	\$80 -

If sales have also been made to J. B. Grover \$100; T. L. Johnson \$150; R. S. Moore \$90; and O. B. Jackson \$80, these transactions might be recorded in the same way. Effort will be saved,

however, if a group entry is made, consisting of individual debits to each of the customers and one credit to Sales for the total amount of the debits as follows:

John R. Barry.....	\$ 80 -
J. B. Grover.....	100 -
T. L. Johnson.....	150 -
R. S. Moore.....	90 -
O. B. Jackson.....	80 -
Merchandise Sales.....	\$500 -

The student will see later how this group entry is made the basis of the entry in the sales journal.

The Sales Journal Record.—The form and manner of operation of the sales journal (Form 8), are similar to those of the purchase journal. The sales journal records nothing but sales of stock-in-trade. The manner of making the record in the sales journal follows almost exactly the principle of the group entry already explained. As to form and the use of columns, the sales journal is exactly similar to the purchase journal. Both differ from the general journal in two main particulars: (1) The showing of debit and credit is not made by means of margins, and (2) the money columns have no debit and credit significance, the first column showing detailed amounts, the second column, totals.

In the purchase journal it was the credit side of the entry which differed for each entry involving a purchase, while the debit was always to Purchases account. The analysis of a sales transaction shows, however, that it is the debit side of the transaction which differs with every sale, the credit side, "Merchandise Sales, Cr.," remaining unchanged. Hence, in the sales journal it is the debit side, i.e., the charge to each customer, which is made from day to day as the sales occur. At the end of the month a summary credit to Merchandise Sales account is made, the amount being the total of the charges to customers' accounts entered from day to day.

Every sale is analyzed completely as to its debits and credits by the daily entry in the sales journal, but to save time and effort the method of the group entry is used, the one credit to Merchandise Sales at the end of the month being sufficient to restore the equilibrium of the journal.

To illustrate, the following sales transactions will be recorded, first, in the general journal and, second, in the sales journal.

April 19—

1. A furniture dealer sold to Richard Robbins:
 - 1 Office desk \$175.
 - 1 Typewriter desk \$80, the terms being 2/10, n/30.
2. Sold to John Duncan:
 - 2 Filing cabinets at \$100.
 - 3 Chairs at \$15, terms on a/c.
30. A sale was made to J. L. Newberry of:
 - 2 Typewriters at \$120.
 - 1 Mimeograph \$150, terms being n/30.

Recorded in the general journal without explanations:

April 1, 19—				(Page 7)
Richard Robbins		255	—	
Merchandise Sales	18		255	—
	2			(Page 10)
John Duncan		245	—	
Merchandise Sales	18		245	—
	30			(Page 23)
J. L. Newberry		390	—	
Merchandise Sales	18		390	—

With a general journal, the Sales account, after posting, will show the individual sales as follows:

MERCHANDISE SALES				(Page 18)
		19—		
		Apr.	1	J 7 255 —
			2	J 10 245 —
			30	J 23 390 —

The same transactions would appear in the sales journal, as follows:

SALES JOURNAL

(Page 1)

19—					
Apr.	1	Richard Robbins, Utica, N. Y., 2/10, n/30	27		
		1 Office Desk, # 47		175	—
		1 Typewriter Desk # 81		80	—
					255 —
	2	John Duncan, Trenton, N. J., on a/c	28		
		2 Filing Cabinets # 22 @ \$100		200	—
		3 Chairs # A9 @ \$15		45	—
					245 —
	30	J. L. Newberry, Bflo., N. Y., n/30	29		
		2 Typewriters # U70 @ \$120		240	—
		1 Mimeograph # E1		150	—
					390 —
	30	Merchandise Sales, Cr.	18		890 —

COMMENTS. The student will note that here, also, there is no use of margins for showing debit and credit. A uniform margin to give the detail of each sale is observed, however. At the close of the month the credit entry, "Sales, Cr.," is shown, it being customary to use the term, "Cr.," inasmuch as the position of the account title, Sales, does not indicate either debit or credit. As to rulings it will be noted that the single line extends through one money column, that the double lines, indicating the definite separation between the sales journal record for the month of April and that for May, which will immediately follow, extends through the date column, the ledger folio column, and the two money columns; in other words, the double rules extend through all of the columns except the wide explanatory column.

Posting the Sales Journal.—The problem of posting the sales journal is similar to that of posting the purchase journal. In order to keep the information as to customers' balances up to date, the entries made in the sales journal must be posted every day. When posting from the purchase journal, the entries to

creditors' accounts are always on the credit side of those accounts. In posting the sales journal, however, the entries to customers' accounts are always on the debit side. Since only the debit side of each transaction is posted daily, the ledger will not be in equilibrium during the month and therefore a trial balance should not be taken from it. At the end of the month, however, when a credit to Merchandise Sales account for the amount shown by the "Merchandise Sales, Cr.," or summary entry in the sales journal, is posted, the equilibrium of the ledger is re-established. The student should be careful to post mark (cross-index) all items posted and write the letter "S," the initial of the sales journal, near the folio column in the ledger.

When the sales journal is used the Merchandise Sales account will show in one amount the total of the sales instead of the individual items. Note the use of the letter "S" to indicate the book of original entry.

MERCHANDISE SALES

(Page 18)

					19— Apr. 30		S	I	890 —	
					RICHARD ROBBINS				(Page 27)	
19— Apr. 1		S	I	255	—					
					JOHN DUNCAN				(Page 28)	
19— Apr. 2		S	I	245	—					
					J. L. NEWBERRY				(Page 29)	
19— Apr. 30		S	I	390	—					

Sales Journal—New Form.—The new form of sales journal is similar to the last form of purchase journal shown on page 301. A sales journal in this form cannot be used unless sales tickets

or invoices of all sales are made in duplicate and one copy retained by the seller. If sales are numbered consecutively, these duplicates may be filed numerically. Details of any particular sale can be quickly found by this method.

Sales Journal

Date	Inv. No.	Name	Address	Terms	F	Amount
19- Apr	1	Richard Robbins	Utica, N.Y.	2/10 N/30		255-
	2	John Duncan	Denton, N.J.	on a/c		245-
30	3	J. L. Newberry	Buffalo, N.Y.	on a/c		990-
30		Madison Sales Co.				890-

Form 8. Sales Journal

Standard-ruled journal paper can be converted into this type of sales journal by using the last money column for the amount of the sale and writing in the headings as indicated.

Volume of Business Done with Each Customer.—As was the case with purchases, it is frequently desirable to have full information as to the volume of business done with each customer. This is of use to the sales department in comparing the amount of sales made to customers during different periods of time—months, seasons, or years. The credit department can also use this information in determining the amount of credit to extend to customers. This information is usually more useful than similar information in regard to creditors for the above reasons. It is therefore necessary to set up the customer's account whether the sale is for cash or on credit. In many businesses, however, this is not done, a shorter method being employed which does away with the customer's account when the sale is for cash.

Suppose that a sale of merchandise was made to J. R. Quincy for cash, \$50. In accordance with the method to be followed here, the entries will be as follows:

April 20

J. R. Quincy.....	\$50 -	
Merchandise Sales.....		\$50 -

April 20

Cash.....	\$50 -	
J. R. Quincy.....		\$50 -

The net effect of the two entries is to show a debit to Cash of \$50 and a credit to Sales of \$50, the debit and the credit in Quincy's account just balancing each other. If a record of the volume of business done with Quincy is not desired, the debit to Quincy in the sales journal and the credit in the general journal may be checked (✓). A check mark in the folio column indicates that the item is not to be posted.

When a sales journal is used all cash sales will first be entered therein as debits to the customer and credits to Merchandise Sales account. Whenever payment is received—whether at future date or at the time of sale—another entry must be made in the general journal, taking the form:

Cash.....	\$....	
Customer.....		\$....

The method of the *two* entries just shown will be used to bring out clearly the principle involved.

Other Sales Transactions.—Another kind of transaction most conveniently recorded in the sales journal is the withdrawal of commodities from the store by the proprietor or proprietors for personal use. These are charged to the proprietors, so far as possible, at cost price. As the goods are withdrawn at the same price at which they were purchased, no profit is involved and the transactions therefore differ from the sale of stock-in-trade to customers. It is customary to record such transactions, however, in the sales journal, the current record being the charge to the proprietor, the credit being included in the total credit to Sales account at the end of the month.

Also it often happens that the crating and packing material which came with goods purchased cannot all be used and is disposed of to others. The most convenient way of bringing the charge to the purchaser on the books is through the sales journal. These charges are also offset by the summary credit entry to Sales at the close of the month. While not strictly a sale of stock-in-trade, there is no serious objection to this, as items of this kind are relatively small in amount.

Advantages of the Sales Journal.—The advantages of the sales journal are:

1. Great saving of time and space in recording, especially when the abstract form (one line to a sale) of sales journal is used.
2. Fewer postings. Only one more than one-half the former number are required.
3. Much space saved in the Sales account in the ledger.
4. Less chance of making errors in posting.
5. Provides for subdivision of labor. Three persons can work at the same time.
6. Convenient for reference because all sales are in one book.

QUESTIONS

1. Explain the effect on the fundamental accounting equation of a sale of merchandise.
2. What is meant by "journalizing sales by groups?"
3. What is a sales journal?
4. What kind of sales transactions are recorded in the sales journal?
5. If an automobile company sold part of its real estate, would the entry be made in the sales journal? Explain.
6. What element of the transaction is suppressed in the sales journal?
7. (a) When is the summary entry recorded in the sales journal?
(b) Why is the term "Cr." used in the summary entry?
8. (a) How is a sales journal ruled off or closed?
(b) Why is this necessary?
9. (a) Why are the debits of the sales journal posted daily?
(b) Why is the credit posted at the end of the period?

10. Why is it impossible to take a trial balance before posting the summary entry of the sales journal?
11. Explain the condensed or abstract form of the sales journal.
12. How would you convert a sheet of standard-ruled journal paper into the condensed or abstract form of the sales journal?
13. (a) How may the volume of business done with each customer be obtained?
(b) Name two or more possible uses for this information.
14. If the proprietor withdraws merchandise for his personal use, is the entry recorded in the sales journal? Why?
15. Where would you enter the sale of small items, such as packing boxes, which came with purchases? Why?
16. Are cash sales recorded in the sales journal? Explain.
17. What is the effect of a check mark (✓) in the folio column in a journal?
18. If a note is received from a customer on the day of the sale, how is the transaction recorded?
19. Compare the sales journal and purchase journal.
20. State the advantages obtained by using a sales journal.

PROBLEMS

1. (a) On a sheet of journal paper write up a sales journal for the following sales made by the Acme Stationery Company, whose terms are 2/10, n/30.

September, 19—

1. Sold to J. T. Dempsey, on account, office supplies for \$475.
3. Sold to Wyler Sons Company, on account, printed forms for \$325.
5. Sold to J. Simon and Company office stationery, on account, for \$150.
7. Sold to Wyler Sons Company, on account, 2 Waterman's fountain pens at \$3.50 each.

(b) Summarize and rule the sales journal.

(c) Using one-half sheet of ledger paper, post the sales journal.

2. (a) Record the following transactions in a sales journal for the Dayton Auto Supply Company.

December, 19—

1. Sold to J. N. White, on account, 2 auto casings at \$70 each and 2 tubes at \$9 each.

3. Sold to Louis Bauman on account:
 - 2 Air Gauges at \$1.25 each.
 - 1 Auto Casing at \$45 each.
 - 2 Auto Tubes at \$8 each.
5. Sold to Dayton Repair Shop, on account, repair material for \$175.
7. Sold to Bay State Repair Company, on account, a bill of accessories \$150.
9. Sold to Geo. O. Wagner on account:
 - 6 Fisk Tires at \$45 each.
 - 6 Fisk Tires at \$54 each.
 - 10 Fisk Tires at \$8 each.

(b) Summarize and rule the sales journal.

(c) Using one-half sheet of ledger paper, post the sales journal.

3. (a) Write up the following transactions for the Haddon Book Store. Use a sales and a purchase journal.

October, 19—

1. Sold to Adolph Hayes, Nashville, Tenn., terms n/30:
 - 1 History Textbook, \$2.75.
 - 1 Volume of Browning, \$2.
 - 1 Fountain Pen, \$3.50.
 - Note Books, \$.50.
3. Purchased from the Ronald Press Company, New York, N. Y., terms n/60, a stock of textbooks for \$800.
5. Sold to R. N. Row, Memphis, Tenn., 3 English textbooks at \$1.75 each, terms n/30.
6. Sold to Brownson School, Cincinnati, Ohio, terms n/30:
 - 24 Kester's Vol. I Accounting with working material at \$4 each.
 - 24 Kester's Vol. II Accounting at \$5 each.
 - 10 Boxes Journal Paper at \$5 each.
 - 10 Boxes Ledger Paper at \$5 each.
7. Purchased from the Macmillan Company, Chicago, Ill., terms 2/10, n/30, 500 textbooks at \$2.70 each.
8. Purchased from Cleveland Book Concern, Cleveland, Ohio, terms 2/10, n/30, 250 volumes of fiction totaling \$675.
9. Sold to Lawrenceburg School, Lawrenceburg, Ind., terms 2/10, n/30:
 - 24 Salisbury's Geographies at \$2.50 each.
 - 24 Volumes Century Readings at \$2.75 each.
 - 24 Volumes of Shakespeare at \$2 each.

(b) Summarize and rule both journals.

(c) Post from both journals.

4. (a) Write up the following transactions for the International Grain Company, whose terms are 2/10, n/60. Use a general, sales, and purchase journal.

July, 19—

2. Sold to Davis Horton on account 100 bu. wheat at \$1.75; 150 bu. #2 yellow corn at 83c.
3. One ton of hay was taken as feed for the company's horses, \$25.
6. Bought from H. E. Newman for cash 300 bu. wheat at \$1.60.
8. Sold to Robert M. Morgan, Produce Exchange, taking payment one-third in cash, one-third on account, and a 30-day note for the remainder; 400 bu. #2 wheat at \$1.70; 400 bu. #2 corn at 85c.; 150 bu. #3 white oats at 50c.
10. Sold to M. V. Day for cash, empty barrels \$6.
12. Bought from Joseph Ross for cash 1,000 lb. straw at \$5 for use in the business.
- *15. Paid the Ruoff Milling Company \$2,000 on account.
18. Bought 50 tons of timothy hay from J. E. Cleves at \$24 per ton, terms n/30.
24. Paid 30-day note for \$1,000 due today with 6% interest.

(b) Summarize and rule the sales and purchase journals.

(c) Post from general, sales, and purchase journals.

5. (a) Write up the following transactions for the Benham Lumber Company, whose terms are 2/10, n/60. Use a general, sales, and purchase journal.

November, 19—

1. Sold to H. L. Ehlers, on account, 5,000 ft. Pa. Hemlock at \$37 M.
5. Sold to Edward D. Watson, on account, 3,000 ft. yellow pine at \$110 M; 4,000 ft. plain oak at \$200 M.
7. Bought from Young and Kennitt 10,000 ft. yellow pine at \$100 M; 10,000 ft. plain poplar at \$150 M. Paid for it by giving cash for one-half and 60-day note for the remainder.
9. Bought postage stamps for cash \$25.
12. Paid account with Garnes Brothers Company, \$2,000, less 2%.
15. Used 500 ft. yellow pine at \$100 M for making partitions for the company.
18. Bought from Young and Kennitt 5,000 ft. yellow pine at \$100 M, terms n/30.

20. Sold to Ripley Furniture Company, on account:
 - 500 ft. Mahogany at \$ 37 C.
 - 3,000 ft. Qtd. Oak at \$325 M.
 - 5,000 ft. Plain Oak at \$225 M.
 24. Paid salaries of office employees in cash \$600.
 26. Received payment from the Ripley Furniture Company for their account in full \$2,235, less 2%.
- (b) Summarize and rule the sales and purchase journals.
- (c) Post from all three of the journals.

CHAPTER XX

THE CASH RECEIPTS JOURNAL

Purpose of Chapter.—

1. Analysis of cash receipts.
2. Form and operation of the cash receipts journal.
3. Split transactions.

Cash Receipts.—By **cash** we mean money, or what represents money. Checks are always treated as cash, even though sometimes they prove uncollectible. It is customary to accept a check as payment for a debt, always and only on condition that the check proves collectible. In case collection cannot be made, the debt is not considered as having been paid. In some small businesses where records are not properly kept, one occasionally finds postage, revenue stamps, and street-car tickets included in the cash. This is not the standard method of handling these items and will not be discussed here in connection with cash.

The Cash Receipt Analyzed.—The student can doubtless think of a number of different sources of cash. He knows that in the first place cash is paid in by the owner or owners for the purpose of conducting the business. After the business gets under way and sales are made, cash will be received from customers who pay cash for goods bought, and also from other customers when they pay their accounts for goods sold on credit. Some customers may have given notes for which they pay cash in settlement when they come due. Cash may also be received for interest on the notes. The owner of the business may have to borrow money from a lender, who may be either a bank or private individual. These comprise the main sources of cash. Other

occasional sources are from the sale of scrap material, old packing boxes, crates, barrels, etc. A business man may also dispose of his store fixtures and furniture. He may tear out the counters and show cases and put in new ones, selling the old fixtures for whatever they may bring. Many kinds of transactions therefore involve the receipt of cash.

The effect of the receipt of cash will in all cases be an increase in assets; the other effect will depend upon the nature of the transaction. In some cases the receipt of cash brings about a decrease in other assets. For example, when cash is received from a customer on account, we have an increase in the asset, Cash, and a decrease in the asset, Accounts Receivable. The receipt of cash may result in an increase in liabilities. When money is borrowed, there arises a liability to the lender of the money. In some instances the receipt of cash may cause an increase in capital. For example, when the proprietor invests cash in his business, the result is an increase in the asset, Cash, and an equal increase in capital. Thus a cash receipt may be offset in any one of three ways, namely, a decrease in another asset, an increase in a liability, or an increase in capital.

Journalizing Cash Receipts.—It follows from the above that the debit and credit analysis will be either:

1. A debit to Cash and a credit to an asset account.
2. A debit to Cash and a credit to a liability account, either the personal account of the lender or a note payable account, where a formal promise to pay was given.
3. A debit to Cash and a credit to a capital account.

Note that in every entry there is a debit to Cash. It is only the credit side of the entry which differs in accordance with the sources of the receipt. It will therefore be possible to make a group journal entry involving writing only once the "Cash, Dr." for the total amount of cash received, the individual credit items showing the source of each receipt. This will bring about a

marked saving of labor and time and may include the cash transactions of one day, one week, or even a month, depending upon the wish of the owner as to how frequently he desires information concerning this group of transactions.

The Cash Receipts Journal Record.—From this group entry grew the cash receipts journal (Form 9) which is fundamentally the same as the other special journals previously explained. At the left of the page are the date columns. Next comes the wide explanatory column for the name of the account to be credited. Following this on the same line and as many of the next lines as are necessary is a full explanation of the transaction. Then comes the ledger folio column. The money columns do not have the debit and credit significance which they have in the general journal. Just as with the purchase and sales journal, the first column is a detail column while the second is a total column. The bookkeeper thus uses an abbreviated method in the cash receipts journal by stating currently for each transaction only the credit item. This entry is a complete debit and credit analysis of the transaction, but since nothing but cash receipts are recorded here, it is not necessary to set up formally the Cash, Dr. for each one of the transactions. At regular periods, however, sometimes weekly, sometimes monthly, the journal is summarized and the Cash, Dr. item is entered, the same way that the purchase journal is summarized. The effect of this is to bring about one Cash, Dr. just equaled by the credits already made in the cash journal. While this does not follow the debit and credit form of the general journal as to margins, the effect is exactly the same.

Form of the Cash Receipts Journal.—To illustrate the form and use of the cash receipts journal, suppose that the following transactions have taken place during a month:

April, 19—

1. A. B. Conrad, the proprietor, invested \$5,000 in cash.
7. Received \$500 in cash from John Jones in full of account.

14. Borrowed \$1,000 from the Merchants Bank on his 30-day note with interest at 6%.
 20. Sold D. E. Field's bill of goods for cash \$700 (first record appears in the sales journal).
 30. Received check for \$100 from James Lowell for rent of office for May.
- Robert Norris paid his 30-day note of 3/31—, \$1,000, with interest at 6%.

These transactions would appear as follows:

Cash Receipts Journal

<i>Date</i>	<i>Accounts Cr</i>	<i>Explanation</i>	<i>F</i>	<i>Items</i>	<i>Total</i>
<i>Apr 1</i>	<i>A.B. Conrad Co.</i>	<i>investment</i>		<i>5000 —</i>	
<i>7</i>	<i>John Jones</i>	<i>in full of a/c</i>		<i>500 —</i>	
<i>14</i>	<i>Notes Payable</i>	<i>30 day note, int. 6%</i>		<i>1000 —</i>	
		<i>from Merchants Bk.</i>			
<i>20</i>	<i>D. E. Fields</i>	<i>today's sale # 37</i>		<i>700 —</i>	
<i>30</i>	<i>Rent</i>	<i>J. Lowell chkr for</i>		<i>100 —</i>	
		<i>office rent for May</i>			
<i>30</i>	<i>Notes Receivable</i>	<i>R. Norris for 30 da</i>		<i>1000 —</i>	
		<i>note of 3/31— with</i>			
		<i>int. at 6%</i>			
<i>30</i>	<i>Interest</i>	<i>30 day at 6% on above</i>		<i>5 —</i>	
<i>30</i>	<i>Cash Dr</i>				<i>\$3005 —</i>

Form 9. The Cash Receipts Journal

COMMENTS. The student will note that at the time the entries are made only the credit account appears, that a somewhat uniform margin immediately following the account title is observed for the statement of explanatory data, that the first column is used to show the detail of the cash receipts, and the second column shows the total of the detailed receipts, listed in the first column, this total being extended into the second column on the next line below the last item in the first column. At the end of this first month the journal is summarized and the debit

entry, that is, Cash, Dr., is shown for the total amount of cash received for the month as appearing in the second column. The double rules for this journal are exactly the same as those for the purchase and sales journals. The student should make sure that he understands the operation of the cash receipts journal.

Posting the Cash Receipts Journal.—It is customary to post at the close of each day the items which have been entered in the cash receipts journal. Since the debit element of each entry is suppressed currently and brought onto the journal only at the time of summarizing, the account titles which have been entered in the cash receipts journal are all credits. Only credit posting will therefore be made to the ledger, throwing it out of balance temporarily. When the summary entry, Cash, Dr., is entered it exactly equals the itemized credits set up from day to day. When this is posted to the debit side of the Cash account, the ledger will be in equilibrium again. Since a trial balance is usually taken at the end of each month the cash receipts journal must always be summarized and posted completely before that time. Be sure to place the letter "C" near the folio column in the ledger to indicate the special journal from which the item was posted.

Comparison with the Purchase Journal.—The cash receipts and purchase journals are similar in that they both group debits and credits in the same manner, i.e., the day-to-day items are all credits and the total provides the debit item. They are unlike in the effect of the credits. The credits in the purchase journal are all increases in accounts payable or liabilities, while the credits in the cash receipts journal may record: (1) a decrease in assets, (2) an increase in liabilities, or (3) an increase in capital. There may also be some difference in the arrangement of the transactions on the pages. However, fundamentally they are alike because both are special journals designed to organize debits

and credits in group form for convenience in collecting information and arranging it for easy transfer to the ledger.

Advantages of the Cash Receipts Journal.—The advantages of the other special journals—purchase and sales—apply with equal force to this journal, and it is not deemed necessary to repeat them here.

Split Transactions.—When special journals are used, it sometimes becomes necessary to *split* a transaction, i.e., analyze it according to the special journals in use and then record it by using two or more journals.

Customers often take advantage of discounts on sales by early cash payment. The nature of sales discount and the method of recording it when only one journal—the general journal—is used were fully discussed in Chapter XVII. To illustrate the method of handling such a transaction, we shall show the record of the payment: (1) when only a general journal is used, and (2) when the general journal and the cash receipts journal are used.

Assume that on April 7, 19—, Thomas Cameron paid \$980 in cash for sale of March 28, \$1,000, less 2% in 10 days.

1. Recorded in the general journal only, this transaction will appear as follows:

Cash.....	\$980 -
Sales Discount.....	20 -
Thomas Cameron.....	\$1,000 -

2. When the general journal and cash receipts journal are used, the transaction will be entered as follows:

CASH RECEIPTS JOURNAL

19—						
Apr.	7	Thomas Cameron	sale of 3/28/—, less 2%.	980	-	
			See J. p.—			

GENERAL JOURNAL

April 7, 19—				
Sales Discounts		20	—	
Thomas Cameron				20 —
Allowance of 2% cash disct. on \$1,000				
sale of 3/28/—. See C. R. J. p.—				

These two entries have the same effect as the single general journal entry. The entry in the cash receipts journal credits Cameron's account \$980 and provides for including the \$980 as a debit to Cash when this journal is summarized. The entry in the general journal indicates a debit to Sales Discount of \$20 and a credit to Thomas Cameron's account of \$20. The change in Thomas Cameron's account consists of two credits, one of \$980 and another of \$20, instead of one amount of \$1,000.

Other examples of split transaction requiring entries in more than one journal are given below:

1. The discounting of a note receivable or note payable.
This would be handled in the same manner as the sales discount transaction above, except that in the general journal the debit would be to Interest Cost account and the credit to Notes Receivable or Notes Payable, depending on whether the note discounted was someone's else or our own.
2. Cash sales recorded in the sales journal.
3. Sales recorded in the sales journal that are paid in whole or in part by promissory notes or any other property at the time of sale. (No part of this transaction is recorded in the cash receipts journal.)

QUESTIONS

1. What do you understand by a "cash transaction"?
2. On what condition is a check accepted as payment for a debt?
3. Name as many as you can of the main sources from which cash is received in an ordinary business.

4. What are some of the occasional sources of cash?
5. Explain the increases and decreases of the asset, liability, and capital elements in each of the following transactions:
 - (a) Cash investment in a business.
 - (b) Cash received from a customer paying an account.
 - (c) " " " " " for a cash sale.
 - (d) " " " " " settling his note.
 - (e) " " " " " paying interest on his note.
 - (f) " " for the proprietor's own note used for borrowing money at a bank.
 - (g) " " from a tenant for rent.
 - (h) " " for wages or salaries for services rendered.
6. Name the credits and debits in each of the cases under Question 5.
7. What in each of the examples of Question 5 is the debit element?
8. How, therefore, in this group of transactions is it possible to make a group entry for cash receipts?
9. What form does this group entry take in the cash receipts journal, i.e., is it the regular journal form?
10. How is a cash receipt entered currently in the cash receipts journal?
11. How finally is the group entry completed?
12. Explain the uses of the various columns in the cash receipts journal?
13. Are margins made use of to indicate the debits and credits of the entry? Why?
14. How often is the cash receipts journal summarized?
15. When should the current record in the cash receipts journal be posted?
16. What is the effect on the equilibrium of the ledger of this day-to-day posting?
17. When is the summary entry posted?
18. What is the effect of the posting of the summary entry on the equilibrium of the ledger?
19. How are the ledger and journal entries cross-indexed?
20. Which one of the other journals has its debit element suppressed?
21. Compare the cash receipts journal and the purchase journal.
22. What are the advantages of the cash receipts journal?
23. What is meant by a "split transaction"?
24. Explain the method of entering a transaction involving a cash discount.
25. Give several other examples of transactions requiring records in two or more journals.

PROBLEMS

1. (a) Write up a cash receipts journal for the following transactions:

June, 19—

1. James T. Carlton began business with a cash investment of \$5,000.
5. Received cash of \$500 from C. N. Jackson on account.
8. Received cash of \$200 from A. B. Conroy for rent of building.
10. Received cash of \$2,000 from John D. Wright in payment for his 30-day note.

(b) Summarize and rule the cash receipts journal.

2. (a) Write up a general and a cash receipts journal for the following transactions:

August, 19—

5. John Tompkins began business with an investment of \$10,000 cash and \$2,000 in furniture and fixtures.
7. Received cash of \$200 from Elgin Sales Company for rent of adjoining storeroom.
10. Blue Ribbon Dairy Company paid their account of \$875 by check for \$400 and their 30-day note for \$475.
15. Received payment on T. M. Well's note of \$1,000, with 6% interest for 60 days, \$10, total \$1,010.
25. Received check for \$392 from Hollander Brothers paying for goods sold to them \$400, less 2%.

(b) Summarize and rule the cash receipts journal.

(c) Post to a ledger sheet of paper the entries from both journals.

3. (a) From the following transactions pick out the items belonging in the cash receipts journal and enter them.

January, 19—

3. R. L. Badger started business with an investment of \$5,000 cash and \$6,000 merchandise.
5. Sold merchandise to Harry C. Knox, on account, for \$600, terms 2/10, n/30.
7. Bought merchandise from Cleveland and Company, on account, \$7,000.
10. William Grant paid his 90-day note of \$2,000 with 6% interest, total \$2,030.
15. Received check for \$588 from Harry C. Knox paying account in full, \$600, less 2%.

17. Sold merchandise to H. E. Blackwell for cash \$800.
20. Paid clerks' salaries in cash \$300.
25. Paid Cleveland and Company for merchandise purchased on January 7, \$7,000.

(b) Summarize and rule the cash receipts journal.

4. (a) Write up general, cash receipts, purchase, and sales journals for the following transactions:

June, 19—

1. George A. Harper opened a furniture business with cash \$10,000 and merchandise \$25,000.
3. Sold the following merchandise to L. C. Kirk, Pittsburgh, Pa., terms n/10. 1 office desk \$125, 1 chair \$15.
5. Bought stationery for use in the office from Philadelphia Stationers, on account, \$250.
6. Sold merchandise, on account, to M. E. Farley \$1,500, terms 3/10, n/40.
8. Bought from Laswell Wholesale Furniture Company, New York, N. Y., 3 oak bedroom suites at \$400 each, terms 2/10, n/60.
14. Received cash from M. E. Farley in full for his account of the 6th, less 3%.
15. Received L. C. Kirk's check for goods purchased on June 3, amount \$140.
16. Bought merchandise from Laswell Wholesale Furniture Company, amounting to \$4,000, terms 2/10, n/60.
20. Sold a bill of furniture to Harry E. Copeland, Pittsburgh, Pa., for cash \$2,500.

(b) Summarize and rule the cash receipts, sales, and purchase journals.

(c) On a sheet of ledger paper post all of the entries made.

CHAPTER XXI

THE CASH DISBURSEMENTS JOURNAL

Purpose of Chapter.—

1. Analysis of cash disbursements.
2. Form and operation of cash disbursements journals.
3. Split transactions.

Cash Disbursements.—Just as the cash receipts journal contains only cash received, so the cash disbursements journal is limited to those transactions involving cash paid out. The student is referred to Chapters IV and XX for a discussion of what is meant by “cash.” As here used, unusual forms of cash, such as postage and revenue stamps and street-car tickets, will not be included. Since this journal will record no transactions except those involving the disbursement of cash, its title is self-explanatory.

Analysis of a Cash Disbursement.—In Chapter XX it was shown that the sources from which cash is received comprise, usually:

1. The original investment of the owner or owners.
2. Sales to customers either on open account or on account of notes which they have given.
3. Interest income, rent income, etc.
4. Miscellaneous sources, such as the sale of furniture and fixtures, packing boxes, crates, etc.

In the same way the reasons for the expenditure of cash may be classified:

1. Upon the organization of a business cash may be spent for necessary physical equipment, including store furniture and

fixtures, desks, typewriters, safe, etc., delivery equipment, and even the building and land where the business is to be conducted.

2. The next expenditure involves the purchase of stock-in-trade. Sometimes these purchases may be on account, that is, the cash is not paid at the time of the purchase.

3. This will involve at some later date the settlement of the accounts or notes payable for goods previously purchased.

4. Throughout the course of the business, cash must be expended for the services of salesmen, clerks, bookkeepers, stenographers, cashier, etc., janitor service, supplies, such as fuel, light, wrapping-paper, twine, boxes, crates and cartons—in fact all items which can be classed as expenses.

5. Occasionally, also, there will be cash refunds to customers upon the return of unsatisfactory material.

6. There will also be cash given in change, as when a customer gives a check for an amount larger than his bill.

7. The proprietor may withdraw cash for personal use.

8. Occasionally one finds an exchange of checks as a matter of convenience and courtesy to a customer desiring to send money by check to an out-of-town person, the merchant's check having better standing because he is more widely known. This somewhat unusual procedure will not be discussed in this chapter.

In reviewing these transactions, note that in the first and second cases the result of the expenditure was an exchange of assets, the decrease of the asset, Cash, and the increase of assets, such as store furniture and fixtures, stock-in-trade, etc. In the third case the decrease in the asset, Cash, was equaled by a decrease in the liability accounts or notes payable. In the fourth case the cash expenditure may be said to result in a decrease in capital, where payment was made for the services of salesmen, clerks, or other expense purchases which have been consumed at the time the disbursement occurred. Therefore, a cash expenditure may be reflected by an increase in assets, a decrease in liabilities, or a decrease in capital.

Journalizing Cash Disbursements.—In journalizing transactions involving the disbursement of cash the credit item is always a credit to Cash. Were all of the cash disbursement transactions held over for entry to the close of the day, a group entry could be made which would show as debits the several accounts representing: (1) increase in assets, (2) decrease in liabilities, or (3) decrease in capital, and one credit to Cash for the total amount. We may enter the transactions of a day, a week, or even a month in one group entry. It is only a step from this method of group entries to a special journal.

The Cash Disbursements Journal Record.—Where a special journal is used exclusively to record cash disbursements, the entries made from day to day are incomplete to the extent that the credit item of each entry is not formally expressed. Since all entries here recorded involve the disbursement of cash, there is no need for a formal statement of the credit item of each entry. Every transaction so recorded, however, has just as complete a debit and credit analysis as if the credit item were formally expressed. At the end of a given time, a week or a month, the credit item, Cash, Cr., is formally set up for the total of all the debits shown in detail for the period.

This journal, therefore, follows the form and method of the journals previously explained. At the extreme left are the date columns followed by the wide explanation column in which is entered the name of the debit account involved in the transaction; this in turn being followed on the same line at a uniform margin by a brief but complete explanation of the transaction, this explanation running over as many lines as are necessary; then comes the ledger folio column followed by the two money columns, the first of which is for the record of the detailed disbursement items, while the second is used to show the total.

Form of the Cash Disbursements Journal.—To illustrate the form and use of this journal (see Form 10) we shall assume

that the following transactions occurred during the month of April, 19—:

April, 19—

4. Bought a desk for office use from James Smith and Company for \$150 in cash.
7. Paid Styles and Brother by check for bill of office printing and stationery \$63.75.
12. Gave Joseph Webster check for bill of March 15, \$500, less 1%.
16. A. B. Conrad, the proprietor, withdrew \$100 in cash for personal use.
20. Paid \$5 in cash for scrubbing floors and cleaning windows.
27. Bought invoice of merchandise from Bates and Company for cash \$450. (First record appears in the purchase journal.)
30. Paid Ross Brothers by check \$603 for his (Conrad's) 30-day note of April 1, \$600 and 30 days' interest at 6%, \$3.

Cash Disbursements Journal.

Date	Accounts Dr.	Explanation	F	Items	Total
Apr 4	Furn & Fix.	J. Smith & Co. for office desk		150 —	
7	Prtg & Sta.	Styles & Bro. ch. for bill of 4/1-		63.75	
12	Joseph Webster	ch. for inv. #9 \$500 less 1%		495 —	
		See p. page —			
16	A. B. Conrad, Jr.	for personal use		100 —	
20	Expense	cleaning floors and windows		5 —	
27	Bates & Co.	cash purchase #18		450 —	
30	Notes Payable	Ross Bros. for our 30 day note of 4/1- with int. \$600.		600 —	
30	Interest	30 days at 6% on above		3 —	
30	Cash Cr.				1866.75

Form 10. Cash Disbursements Journal

COMMENTS. The titles of some of the accounts, such as Printing and Office Stationery, etc., will depend upon the amount of detailed information desired by the owner of the business. While this item could be charged to General Expense, it is better to give it a more specific title, so that the proprietor will know exactly the object of the expenditure. In each case the account title to be charged is first set up and is then followed by a brief explanation. The summary entry for the month's disbursements is recorded at the close of the month as a credit to Cash, the total being entered in the second column, opposite Cash, Cr. The rulings are the same as for the cash receipts journal.

Posting the Cash Disbursements Journal.—At the close of each day the entries of that day's transactions should be transferred to their respective accounts in the ledger. In every instance the posting will be to the debit side of the account, since only the debit of the transactions has been entered, the credits being temporarily suppressed. This incomplete posting will throw the ledger out of equilibrium for the time being. At the close of the month, however, when the summary entry, Cash, Cr., is set up in the journal and posted to the ledger, the equilibrium will be re-established.

Postings must be post marked (cross-indexed) both in the ledger and in the journal. In the journal the page to which the item was transferred in the ledger will be entered, while in the ledger the letter "C" and the page on which the item is recorded in the special journal will be shown. The time and effort saved by the cash disbursements journal is obvious. In making the journal record the omission of the credit side of each transaction effects a great saving, while the posting of one credit to Cash instead of numerous detailed credits is also a great help.

Comparison with Sales Journal.—Cash disbursements and sales journals have in common the same grouping of debits and credits, i.e., the transactions recorded in each journal from day

to day result in debits, while the credit is obtained from the total of all the items recorded. They differ as to the effect the debits have on assets, liabilities, and capital. All the debits in the sales journal represent increases in the asset, Accounts Receivable, while the debits in the cash disbursements journal may represent: (1) increase in an asset, (2) decrease in a liability, or (3) decrease in capital. There is usually some difference in the arrangement of the details of the transactions on the pages of the two journals. Yet they remain the same fundamentally, because both are devices designed to collect increases and decreases in assets, liabilities, and capital and arrange them in convenient form for transfer to the ledger.

Advantages of the Cash Disbursements Journal.—All the advantages enumerated for the other special journals are applicable to the cash disbursements journal. The student should turn to the cash disbursements journal and reason out these advantages for himself.

Split Transactions.—What was said in Chapter XX about the analysis of transactions for the purpose of making the complete record in two or more journals applies equally well to the cash disbursements journal. The principal types of transactions requiring only a partial record in this journal are:

1. Transactions involving cash discount on purchases.
2. All cash purchases recorded in the purchase journal.
3. The prepayment of notes payable, i.e., the payment before maturity of promissory notes issued by the proprietor on which an allowance is made for early settlement in cash.
4. All transactions involving an allowance for breakage, imperfections, etc., at the time cash payment is made.
5. Another group, no part of which is recorded in the cash disbursements journal at this time, consists of purchases recorded in the purchase journal that are paid at the

time of purchase in whole or in part by promissory notes or other property.

To illustrate the method of handling a transaction involving cash discount on a purchase we shall show the transaction as recorded in the cash disbursements journal and the general journal at the time of payment.

Assume that on April 20, 19—, the proprietor paid Robert Grant \$490 in cash for invoice #7 of April 10, \$500, terms 2/10.

This transaction must be split and recorded in two journals as indicated below:

CASH DISBURSEMENTS JOURNAL

Date	Accounts Dr.	Explanation	F	Items	Total
19— Apr. 20	Robert Grant	inv. # 7, less 2%. See J. p.—		490 —	

GENERAL JOURNAL

	April 20, 19—				
	Robert Grant			10 —	
	Purchase Discounts				10 —
	Allowance of 2% cash disct. on inv. #7				
	See C. D. J. p. —.				

The effect of the records in the two journals is: for the cash disbursements journal, a debit to Robert Grant of \$490 and a credit (suppressed) to Cash of \$490; for the general journal, a debit to Robert Grant's account of \$10 and a credit to Purchase Discounts of \$10. Although Robert Grant's account shows a credit of \$500 entered at the time the proprietor purchased the goods, only \$490 can be entered in the cash disbursements journal as a debit to his account because that is all the cash that has been paid out. After posting this item, Grant's account still

shows a credit of \$10. Since this amount was allowed for early payment it is no longer a liability but represents an increase in capital and therefore must be transferred to some capital account. This is accomplished by the entry in the general journal debiting Robert Grant \$10 and crediting Purchase Discounts \$10.

QUESTIONS

1. What do you understand by a disbursement of cash?
2. Name the main classes of cash expenditures.
3. Explain the increases and decreases of the asset, liability, and proprietorship elements in each of the following transactions:
 - (a) Cash paid for purchase of store and office furniture and fixtures.
 - (b) Cash paid to a creditor for a cash purchase of merchandise.
 - (c) Cash paid to a creditor on open account.
 - (d) Cash paid for payment of a note payable.
 - (e) Cash paid for the use of money—interest.
 - (f) Cash spent for payment of wages and salaries.
 - (g) Cash spent for fuel and light, wrapping paper, twine, stamps, etc.
 - (h) Cash given to customers in settlement of their claims on account of unsatisfactory goods.
 - (i) Cash given to a customer as “change.”
 - (j) Cash withdrawn by the proprietor for other than business purposes.
4. State the debits and credits in each of the transactions of Question 3.
5. How in the group of transactions in Question 3 is it possible to make a group entry for cash disbursements?
6. What form does this group entry take in the cash disbursements journal?
7. After entering the cash disbursements in the cash disbursements journal currently, how is the group entry finally completed?
8. Explain the uses of the various columns in the cash disbursements journal.
9. Why are “margins” not made use of to indicate the debit and credit elements of the entry?
10. How often is the cash disbursements journal summarized?
11. When should the current record be posted?
12. How do the current postings of debits from the cash disbursements journal affect the equilibrium of the ledger?

13. When is the summary entry posted?
14. How does the posting of the summary entry affect the equilibrium of the ledger?
15. Explain a system of cross-indexing ledger and journal entries.
16. Explain the difference between the cash receipts journal and the cash disbursements journal.
17. Compare the cash disbursements journal with the sales journal.
18. Give the principal types of transactions requiring only a partial record in the cash disbursements journal.
19. Explain the method of recording a transaction involving a purchase discount.
20. What are the advantages of using a cash disbursements journal?

PROBLEMS

1. (a) On a sheet of journal paper write up a cash disbursements journal for the following transactions:

October, 19—

5. Paid \$250 to Cornell Realty Company for 1 month's rent.
8. Paid \$500 to Leonard Furniture Company on account.
10. Paid \$300 salary to office employees.
15. Paid \$700 to William Hays for merchandise purchased 30 days ago.

(b) Summarize and rule the cash disbursements journal.

2. (a) Write up a cash disbursements and a cash receipts journal for the following transactions:

September, 19—

1. Robert Grant started business with a cash investment of \$15,000.
6. Paid \$300 to R. B. Frank for 1 month's rent.
8. Received \$1,500 from G. H. Kelley for merchandise sold to him 30 days ago.
14. Paid Martin T. Dickens \$1,300 in full of account.
16. Paid taxes for 1 year \$325.

(b) Summarize and rule both journals.

(c) Post to a sheet of ledger paper the entries made.

3. (a) From the following transactions prepare cash receipts and cash disbursements journals.

April, 19—

1. Paid \$2,000 to Hylan Brothers for merchandise purchased 10 days ago.

10. Purchased furniture and fixtures for use in the office from Drury Brothers, on account, \$1,000.
11. Paid R. T. West cash for merchandise purchased April 1, invoice #6, for \$500, terms 2/10.
12. Paid salaries of office employees \$200.
15. Sold merchandise to C. E. Nest and Company for cash \$700.
21. Paid insurance on building to New England Insurance Company \$250.
25. Received payment in full from M. F. Wise for merchandise sold him on account in March, \$1,800.
30. Paid Drury Brothers for furniture and fixtures purchased April 10, \$1,000.

(b) Summarize and rule the cash receipts and cash disbursements journals.

4. (a) Write up general, cash receipts, cash disbursements, sales, and purchase journals for the following transactions:

January, 19—

1. Henry J. Lyons started business with an investment of \$10,000 cash, \$8,000 merchandise, and an account against Miller Brothers \$700.
2. Bought office supplies from the Mason Stationers, on account, \$400. Bought merchandise from Benjamin Brandon \$3,000, terms 2/10.
3. Sold merchandise to the City Garage for \$1,500, terms 2/10.
8. Received cash on account from Miller Brothers \$500.
10. Paid \$110 cash to Frank H. Green for an office desk.
12. Paid Benjamin Brandon by check for bill of the 2d, \$3,000, less 2%.
13. Received payment from the City Garage for merchandise sold January 5, \$1,500, less 2%. Paid cash for merchandise purchased from Hamilton Supply Company \$2,000.
15. Paid the Mason Stationers in full for merchandise purchased January 2, \$400.
17. Sold merchandise to the City Garage for cash \$600.
18. Bought merchandise from Hamilton Supply Company \$3,500, terms 30-day note with interest at 6%.

(b) Summarize and rule the sales, purchase, and cash journals.

(c) Post to a ledger sheet all of the entries made.

(d) Take a trial balance.

CHAPTER XXII

THE CASH BOOK

Purpose of Chapter.—

1. Handling and control of cash.
2. Form and operation of the cash book.
3. The short and over account.

The Cash Book.—In the explanation given in Chapters XX and XXI of the special cash journals separate books were used. This was for the purpose of fixing clearly in mind the principles underlying their operation. In business it is customary—although separate journals are sometimes used—to record cash receipts and disbursements in the same book. This does not mean that the two kinds of transactions are mixed together, nor that the first half of the book is used for, let us say, receipts and the latter half for disbursements. The cash book, as usually operated, records on the even numbered pages—2, 4, 6, etc.—cash receipts, and immediately opposite on the odd numbered pages—3, 5, 7, etc.—cash disbursements. Although these pages are adjoining they nevertheless represent entirely distinct journals.

Debit and Credit Operation of the Cash Book.—Receipts are therefore recorded on pages 2, 4, 6, etc., of this book exactly as they were recorded in the cash receipts journal; and disbursements on pages 3, 5, 7, etc., just as they were recorded in the cash disbursements journal. The debit and credit analysis is the same as if separate books were used. The bookkeeper knows that the even numbered pages record nothing but cash receipts, and the odd numbered pages only cash disbursements. The

cash book secures all the saving of labor and time that the separate books did. The only way in which the operation of the cash book is different is in the ruling of the book at the time the summary entry is made. This will be explained below.

Purpose of the Cash Book.—It is evident that the cash book permits the manager of the business to have under observation at all times the exact status of his cash. He can see how his receipts are running and will therefore know by comparison with his disbursements to date the amount of cash available for use. Accordingly, the cash book gives him a control over his cash which the separate books could not give so conveniently.

Balancing and Ruling.—The amount of the available balance of cash is an important piece of information. It is, therefore, customary at the time the cash journals are summarized to indicate on the face of the cash book the amount of the cash balance. This is, of course, the difference between the receipts and the disbursements. In showing this on the cash book it is customary first to set up the summary entries for each journal as was explained in Chapters XX and XXI. At the end of the week or month, in the cash receipts journal, the debit item, Cash, Dr., is set up (see page 346), and opposite it the total amount received, while in the cash disbursements journal the credit item Cash, Cr., is set up, and opposite it the total amount disbursed. The difference between the two is set up under the title, Balance, in the cash disbursements journal with the amount directly under the amount of the Cash, Cr. item. This forces an equilibrium, which is shown by ruling off the two journals on the same line across the page. The totals of both journals, receipts and disbursements, thus appear opposite each other on the same line. This will usually leave blank lines on one side or the other of the cash book, because the number of transactions is not the same for

each journal. The double ruling separates the current record from the record of the next week or month.

Inasmuch as there was a cash balance, that is, an excess of receipts over disbursements, the amount of this balance as shown in the disbursements journal to force an equilibrium must now be brought down to the place where it belongs in the receipts journal and set up under the proper date as "Balance" with the amount entered in the second column. This balance is entered in the second column, for two reasons:

1. It completely separates the cash receipts for the current week or month, shown in the first column, from the balance brought down. This is desirable because the proprietor likes to know what his receipts for a given time have been.

2. Inasmuch as the balance in the illustration below, \$6,438.25 is already a part of the Cash account in the ledger, because the receipts and disbursements of the previous month have been posted to it, the item must not again be included for posting with the receipts of the new month.

The amount to be posted for each succeeding month, after the first, is the receipts of that month, not including the balance brought over. Were the balance figure set up in the first column it would be included in the total carried into the second column, and so would have to be subtracted before the correct amount to be posted to the Cash account in the ledger could be determined. There are usually good reasons for the way in which things are done in books of account. The student should understand *why* it is not necessary to post the balance and *why* it is necessary to post the current receipts of each week. In order to make clear the operation of the cash book, the transactions of the cash receipts journal as illustrated in Chapter XX and of the cash disbursements journal as illustrated in Chapter XXI, together with additional transactions for the following month are shown in Form 11, the cash book. The method of summarization, of balancing and ruling, and the way in which the balance is brought down should be noted carefully and compared

with the separate cash journals shown in Chapters XX and XXI.

Forwarding.—In the use of the cash book it frequently becomes necessary to carry forward from the bottom of one page, as from the bottom of page 2 to the top of page 4, the total of cash receipts (or cash disbursements, as the case may be). This is done by writing on the last line of page 2, "Forwarded to page 4," and the amount carried forward. This is then shown on the first line of page 4 under the title, "Brought forward from page 2," the amount appearing in the same relative column as on page 2. The carrying forward of cash disbursements totals is done in the same way. It is not customary to balance the cash book at the bottom of each page just because it happens to be the bottom; the balancing is done at regular periods. When the totals of one journal are carried forward to another page it is not necessary to bring forward the totals of the other journal unless the entries of that journal also fill the page on which they appear. Bringing together on opposite pages the record of receipts and disbursements occurring on the same date is not necessary. A simple illustration of forwarding is shown in Form 11 on pages 346-349.

Function as a Detailed Cash Account.—Note that the cash book is handled so far as balancing and ruling are concerned just like a ledger account. As a matter of fact, if only one journal were used to record all transactions with a complete debit and credit analysis of each transaction, the ledger Cash account posted from such a journal would be a duplicate of the record shown in the cash book. The debit postings would be the same as shown on the left-hand side of the cash book, and the credits the same as shown on the right-hand side. The cash book, in addition to comprising two journals, may therefore also serve as a detailed cash account. This leads in some businesses to the omission of a ledger cash account. This, however, makes the ledger record

incomplete and out of balance, so that when taking a trial balance the cash balance, secured from the cash book, must be added. It is better, therefore, to make use of a ledger cash account to which will be posted the totals of the summary entries in the cash book, and so make the ledger record a complete record of all transactions.

Proving the Cash Journals.—The cash receipts journal and the cash disbursements journal are supposed to be complete records of all cash received and expended. In practice, however, errors and differences sometimes creep in. Occasionally the bookkeeper either through oversight or intentionally may neglect to record some cash items. It therefore becomes necessary to prove the record of cash received and disbursed. At the close of each day the actual cash on hand should be counted and this amount compared with the difference between the day's cash receipts and disbursements. The cash book shows how much cash should be on hand, the actual count shows how much cash is on hand. If no errors have been made, the two records should agree. Errors in making change affect the count; failure to record cash received or expended will lead to errors in the cash book record. Naturally the record of the count will govern and must be considered correct, for though the cash book record may call for more cash than the merchant actually has by count, he cannot persuade himself that he has that amount when his count shows that he does not have it. Hence the cash book record must be brought into agreement with the count or physical inventory.

In most businesses it is customary to pay bills by checks instead of money, because the check acts as a receipt and is more convenient to send through the mails when paying persons at a distance. This occasionally results in the cash disbursements exceeding the receipts, although the money payments may have been less than the cash receipts. If checks have been issued the present *book record* of cash on hand may be entered in the cash

Cash Receipts

Date	Accounts Dr	Explanation	F	Items	Total
Apr. 1	A. B. Conrad, Cr.	investment		5000—	
7	John Jones	in full of account		500—	
14	Notes Payable	Merchants Bk. 30 days note without int at 6%		1000—	
20	D. E. Fields	today's sale #137		700—	
30	Rent	J. Lowell chg. for office rent for May		100—	
30	Notes Receivable	R. Morris for 30 day note of 3/31/-		1000—	
30	Interest	30 days at 6% on above		5—	
30	Cash, Dr.				8305—
					8305—
Apr. 30	Balance				643825
May 1	Martin & Jackson	cash sale #25		450—	
5	Irwin & Luggen	on a/c		1000—	
12	Notes Receivable	N. H. Biles for his 30 day interest-bearing note of 4/1/-		500—	
12	Interest	30 days at 6% on above		2.50	
15	Furniture & Fix.	sold filing cabinet		20—	
20	John Hendricks	on account		100—	
22	John Jones	cash sale #45		12560	
23	Land & Buildings	C. F. Hill for part payment on lots #27- 28-29, Block 12, total \$5500 subject to mortgage of \$5000 See J page 1—		500—	
27	D. E. Fields	sale #54, \$200 less 2%		196—	
27	Forwarded to page 4			289410	643825

Cash Disbursements

Date	Accounts Cr.	Explanation	F	Items	Total
Apr 11	Furniture & Fix.	J. Smith & Co. office desk		150-	
7	Printing & Sta.	Stiles & Co. bill of 4/7		63.75	
12	Joseph Webster	ck. for inv. #9. \$500.		497.5-	
		less 1% (See J. page -)			
16	A. B. Conrad, Mgr.	for personal use		100-	
20	Expense	cleaning floors & windows		15-	
27	Butler & Co.	cash purchase #18		450-	
30	Notes Payable	Ross Bros. for our		600-	
		30 day note of 4/11-			
		with int. \$600.			
30	Interest	30 days at 6% on above		3-	
30	Cash, Cr.				1866.75
30	Balance				6438.25
					8305-
May 1	Office Salaries	Bkpr. \$150. Steno. \$175.		325-	
		clerk. \$100.			
3	W. B. Wright	on full of account		920-	
6	McKissam & Roberts	ck. for inv. #14. \$900.		882-	
		less 2% (See J. page -)			
14	Notes Payable	Merchants Bk. for		1000-	
		30 day note of 4/14/-			
20	Advertising	bill of Evening Star		75-	
		for month of Apr.			
29	Joseph Webster	on account		300-	
29	Felt & Co. Inc.	Penn. R.R. for frt		49.70	
		on inv. #19			
31	Forwarded to page 5			3601.70	

Cash Receipts

<i>Date</i>	<i>Accounts Cr.</i>	<i>Explanation</i>	<i>F</i>	<i>Items</i>	<i>Total</i>
<i>May 27</i>	<i>Forwarded</i>	<i>from page 2</i>		<i>2894 10</i>	<i>6438 25</i>
<i>31</i>	<i>Rent</i>	<i>J. Lowell for June office</i>		<i>100 -</i>	
		<i>rent</i>			
<i>31</i>	<i>Cash, Dr.</i>				<i>2994 10</i>
					<i>9432 35</i>
<i>May 31</i>	<i>Balance</i>				<i>5830 65</i>
<i>June 1</i>	<i>John Hendricks</i>	<i>sale #63 \$400 less 2%</i>		<i>392 -</i>	
		<i>See J. page -</i>			
<i>4</i>	<i>Dwin & Swaguy</i>	<i>on account</i>		<i>200 -</i>	
<i>6</i>	<i>Young & Co.</i>	<i>sale #66 \$300 less 1%</i>		<i>297 -</i>	
		<i>See J. page -</i>			
<i>10</i>	<i>Martin & Jackson</i>	<i>on account</i>		<i>150 -</i>	
<i>12</i>	<i>Henry Bishop</i>	<i>cash sale #94</i>		<i>340 -</i>	

Form II. (b)

book daily in ink or pencil figures, or a summary may be prepared, somewhat as follows:

DAILY CASH SUMMARY DATA

1. Old balance of cash.....	\$1,500 -
2. Plus the total receipts.....	400 -
3. Equals total cash.....	\$1,900 -
4. Less total disbursements.....	650 -
5. Equals present cash balance.....	<u>\$1,250 -</u>

VERIFICATION

A. Balance in bank per check book.....	\$1,077.25
B. Plus cash in the store:	
1. In cash register.....	\$ 47.75
2. In safe.....	<u>125 -</u>
C. Equals present cash balance.....	<u>\$1,250 -</u>

The present book balance of cash is verified by counting the cash on hand in the cash drawer, cash register, and safe, and add-

Cash Disbursements.

Date	Accounts Dr.	Explanation	F	Items	Total
May 31	Forwarded	from page 9		360170	
31	Cash, Cr.				360170
31	Balance	on hand			583065
					943235
June 2	H.B. Wright	inv #18, \$300 less 3%		291--	
		see J page -			
7	Cash Short & Over	counterfeit bill		5-	

Cash Book (Continued)

ing to this amount the balance in the bank available after deducting total checks issued from total deposits.

The two special journals—now combined in the cash book—provide the information in regard to item (2), total cash receipts during the day, week or month, and item (4), total cash disbursements during the day, week or month, thereby making the verification of the book record by means of the physical inventory far more convenient than would otherwise be possible.

The Cash Short and Over Account.—To bring the cash book into agreement with the actual amount of cash on hand, it will be necessary to make entries in the cash book. In order to force an agreement with the actual cash on hand if, for example, the cash book record shows that there should be more cash on hand than there is, it will be necessary to enter in the cash disbursements journal the difference between the amount shown by the cash book and the amount shown by the actual count. Since, in order to determine the balance of cash, the total of the cash dis-

bursements journal is subtracted from the total of the cash receipts journal, the inclusion of this item as a disbursement will make the balance of the cash book less than it originally showed by the amount of the difference between the original cash book balance and the actual count of cash, thereby bringing the cash book record into agreement with the count record. It is customary to charge such an amount to an account called "Cash Short and Over."

How Shortages Occur.—A shortage of cash may come about in several ways. Where cash is handled loosely, the proprietor may make a practice of taking cash from the cash drawer for small purchases and supplies or to pay small bills. Unless he leaves a record of these expenditures, or remembers at the close of the day what they have been, the bookkeeper will have no basis for recording the items on the cash disbursements journal. This will cause the balance of the cash book to be larger than the actual amount of cash on hand, because no record has been made in the cash book of certain expenditures. Again, in making change for customers slight errors frequently occur. More cash may be returned to the customer than should be, resulting in a shortage of cash. The term "cash shortage" always means that the actual cash on hand is short of the amount which the cash book shows should be on hand.

How "Overages" Occur.—It sometimes happens that instead of being short the cash is "over," meaning that the actual cash count shows a larger amount than the cash book record calls for. These "overages" usually arise in much the same way as shortages. Errors in making change where not enough cash is given to the customer, and the placing of cash in the cash drawer without recording its source, are the usual causes. To make the cash book agree with the count of cash, more cash must be shown in the record as having been received. Hence it is necessary to enter in the cash receipts journal the amount of the difference between the cash actually on hand and the amount shown by the

cash book. This is credited to the account, Cash Short and Over. These adjustments to make the cash book agree with the physical inventory of cash are made before the cash book is summarized, so that the amount of the adjustments will be included in the postings to the ledger Cash account.

Nature of the Cash Short and Over Account.—When the balance of the Cash Short and Over account is small or when the items posted to it have in the main been small, it is customary to treat the account as a profit and loss account and, therefore, to close it out when profits and losses are summarized at the end of the fiscal period. If the amount is large and appears to be a failure to record the receipt of cash from a customer or the payment of a liability to a creditor, it is usually treated as a balance sheet item. No general principle can be laid down for handling the Cash Short and Over account. It is a matter for the proprietor's judgment each time the books are closed. Other discrepancies handled through the Cash Short and Over account are those arising from the discovery of a counterfeit bill or coin in the cash, from the loss of cash funds in various ways, etc.

Although the cash book is easily adjusted by charging or crediting the Cash Short or Over account whenever the cash is short or over, the student should realize the seriousness of errors which cause a difference in cash, especially a cash shortage. The Cash Short and Over account should be merely a temporary makeshift to force the book records to agree with the cash counted, and the error located as soon as possible; otherwise, if no further attention is paid to the account, there will be great temptation to use it in covering carelessness or fraud. After doing his regular work, therefore, the bookkeeper should exert every effort to find the cause of the error, when he should at once make the necessary counter adjusting entry.

Advantages of the Cash Book.—In addition to the advantages of the cash receipts and cash disbursements journals, the cash

book has other advantages due to combining them in one book and to proving the cash by means of a physical inventory. The advantages of the cash book are summarized below:

1. Saves time and space in recording cash transactions, all receipts and disbursements being entered in more condensed form.
2. Saves time in posting, only one entry being required for the total of each, cash receipts and cash disbursements.
3. Saves space in the cash account, as only totals for weeks or months are posted, providing information in condensed form.
4. There is less chance for making errors in posting because fewer items are transferred.
5. Provides for subdivision of labor.
6. Convenient for reference because all cash transactions are in one book.
7. Provides convenient means of obtaining total receipts and disbursements of cash for reconciling the daily record of cash with the actual count.

QUESTIONS

1. Why is the cash given careful and constant consideration by the manager or owner of a business?
2. How are the cash disbursements related to the cash receipts?
3. Why are the cash disbursements entered on the opposite side of cash receipts instead of being mixed up?
4. What kind of transactions are entered on the even numbered pages of the cash book? On odd numbered pages?
5. How does the operation of the cash book differ from the operation of the separate cash journals?
6. Give the advantages of the cash book over separate cash journals.
7. What is meant by "balancing the cash book"?
8. How is the difference between receipts and disbursements indicated?
9. When balancing the cash book what entry is made on the debit side? On the credit side?

10. When the number of transactions on each side of the cash book are not the same, how is the book ruled?

11. Give two reasons for entering the balance in the second column of the cash receipts journal under the double ruling.

12. How are the cash book items transferred from one page to another?

13. If you reach the bottom of the page on the cash disbursements side but still have several lines open on the cash receipts side, how do you make the transfer?

14. (a) Is the cash book ever used without a Cash account in the ledger?

(b) Is there any objection to it? Why?

15. Why is it necessary to prove the cash journals?

16. How are the cash journals proved?

17. Why should the actual count of cash govern?

18. Illustrate and explain a daily cash summary for a business that pays its bills by checks.

19. Illustrate and explain the verification of the summary for Question 18.

20. When is the Cash Short and Over account used?

21. Give some of the reasons for the actual cash not agreeing with the cash book record.

22. When is the adjusting entry made?

23. When is cash short? When over?

24. What governs the treatment of the Cash Short and Over account at the time of closing the ledger?

25. Is a cash shortage a serious matter? Explain.

26. State all the advantages of the cash book.

PROBLEMS

1. (a) Write up the following transactions in a cash receipts journal:

January, 19—

10. Received cash from Jacob Danzig, on account, \$800.

22. Received cash in payment of Samuel Babcock's account \$1,200.

31. Received payment for merchandise sold to Leonard E. Jones last month \$250.

(b) Summarize but do not rule the cash receipts journal.

(c) Write up the following transactions in a cash disbursement journal.

January, 19—

11. Paid salaries in cash \$300.

22. Paid cash on account to Robert E. Walsh \$500.

(d) Summarize but do not rule the cash disbursements journal.

(e) Place the cash receipts journal at the left of the cash disbursements journal and number the left page 2 and the right page 3. The two cash journals now form a cash book. Enter the Balance, close the cash book, and bring down the Balance for the next period.

2. (a) The following items represent a continuation of the transactions entered in Problem 1. Use the same cash book.

February, 19—

1. Bought office furniture from Nathan Stern for cash \$175.
10. Received cash on account from P. T. O'Brien \$800.
15. Paid cash on account to Fred Mitchell and Company \$500.
17. Paid cash to the New England Insurance Company for insurance on merchandise \$200.
25. Received payment for merchandise sold to Eagle Lumber Company 10 days ago \$965.
26. Paid telephone bill of \$12.
27. Bought office stationery and supplies from Polk Brothers for cash \$250.
28. Received check for \$750 from S. L. Green, paying his 30-day note without interest.

(b) Summarize the cash book.

(c) Close the cash book.

3. (a) Write up a cash book for the following transactions:

May, 19—

10. Thomas Sawyer began business with a cash investment of \$4,000.
15. Received a cash refund for overpayment to Granby and Company \$10.
17. Sold lot adjoining office to Harvey Kellam for cash \$350.
18. \$25 disappeared from cash drawer during the day.
20. Bought an office safe from Dillon Safe Company for cash \$450.
22. Received cash for merchandise sold to H. I. Spencer, May 15, \$500.
24. Paid John Ryan \$490 in cash for invoice #27, \$500, less 2%.
25. The proprietor drew \$200 for personal use.
26. Received check for \$1,000 from B. F. Butler, in payment of his 60-day note without interest.

(b) Summarize the cash book.

(c) Balance and rule the cash book.

4. (a) Write up a cash book for the following transactions:

June, 19—

1. Cash balance \$3,645.
3. T. C. Smith paid his account in full, \$156.
5. Paid Robert H. Allen in full of account, \$188.
7. Paid freight on merchandise received from Butler and Carson \$12.
10. Loaned G. W. Botsford \$300, and took his note for 30 days.
12. Payment of bill for dressmaker's services for the proprietor's wife, Mrs. H. T. Webb, was approved for payment by her and paid by the cashier, \$70.
15. Harley Newton paid his \$30 bill with a check for \$35. The difference was refunded in currency.
17. When cash was counted this day it was found to be short \$10.
20. Paid 60-day note for \$200 in favor of George E. Bender, due today with interest, \$2.
28. A check for \$12 was cashed for M. E. More, one of the employees.
30. Paid Geo. Harper \$200 for rent of store for the month of July.

- (b) Summarize and close the cash book.

5. (a) Write up a cash book for the following transactions:

May, 19—

3. Michael Scandello's cash balance is \$2,670.
4. Paid Robert C. Lowery for merchandise purchased in April, \$1,400, less 2%. Purchased a delivery car from Ford Motor Car Company for cash \$550.
5. Borrowed \$1,000 from the First National Bank on his 60-day note.
6. Received payment for merchandise sold to Clark Machine Works on April 20, \$500, less 2%. Received cash of \$25 from R. H. Fisher for rent of room over store.
7. Received \$10 for sale of old filing cases to James Smith and paid \$65 for new filing cases.
8. Received payment for merchandise sold to Moran Lumber Company 10 days ago, \$965.

- (b) Summarize, balance, and rule cash book.

6. (a) The following transactions are a continuation of Problem 5. Use the same cash book.

May, 19—

10. Paid \$25 for postage stamps.
11. Received \$1,150 for merchandise sold to O'Brien and Mosher.

12. Received check from Hiram Lockwood for merchandise sold him May 4, \$500, less 2%. Paid on account to Mitchell and Moffet \$375.
13. Paid insurance to May 15, next year, \$295. When cash was counted this day it was found to be \$18 less than the cash book showed it to be.
14. Paid note held by Reisinger and Black \$750, and \$7.50 more for 60 days' interest at 6%.
15. Paid salaries to office employees \$575.

(b) Summarize, balance, and rule cash book.

7. (a) The following transactions are a continuation of Problem 6. Use the same cash book.

May, 19—

17. Sold merchandise to B. F. Butler for cash \$1,200. Received cash refund for overpayment to Granby and Company \$9.
18. Sold lot adjoining office to H. K. Black for cash \$350.
19. F. S. Davison paid his \$20 bill with a check for \$25. The difference was refunded in currency.
20. Paid Model Safe Company \$450 for office safe. Received cash from D. E. Browning for note and interest; face of note \$300; interest \$4.75.
21. Michael Scandello, the proprietor, drew \$500 for personal use.
22. \$10 disappeared from cash drawer during the day.
23. A check for \$20 was cashed for Charles Smith, one of the employees. Paid for merchandise purchased from Reynolds and Company, May 15, \$800, less 2% discount.

(b) Summarize, balance, and rule cash book.

8. Open a cash account on a sheet of ledger paper and post cash items for Problems 5, 6, and 7.

9. (a) Record the following transactions using general, sales, and purchase journals and cash book.

October, 19—

1. Albert A. Williams started business at 2025 Main St., Detroit, Mich., investing \$10,000 in cash and \$1,500 in furniture and fixtures. Bought merchandise \$600 from Richard H. Allen on 30-day note with interest at 5%.

3. Bought merchandise from F. A. Ross, 110 Penn St., City, amounting to \$5,000, terms 2/10, n/30.
 5. Sold merchandise to D. K. Lee, 500 Fourth Ave., City, amounting to \$1,800, terms n/30.
 7. Paid rent of building for month of October \$300.
 10. Sent check to F. A. Ross paying for purchase of the 3d. Amount of check \$4,900, discount \$100.
 13. Sold merchandise to John K. Scott, 610 State St., City, for cash \$1,200.
 17. Bought merchandise from F. A. Ross for cash \$800.
 20. When cash was counted, it was found to be over \$25.
 26. The proprietor purchased \$300 household furniture for his home from the Warner Furniture Company, 1215 Lake St., City, and gave in payment an order on his store which was paid in cash.
 30. Paid salaries of office employees \$500.
 31. Paid his 30-day note for \$600 held by Richard H. Allen with interest at 5%. Total amount \$602.50.
- (b) Summarize and close the sales and purchase journals and the cash book.
- (c) Post all of the entries.
- (d) Take a trial balance.

10. (a) The following transactions are a continuation of Problem 9. Use the same journals.

November, 19—

1. Bought merchandise from Lewis and Gray, 1825 Summit St., Toledo, Ohio, amounting to \$6,000, terms one-third in cash, one-third on a 60-day note, and the remainder on account.
5. Sold merchandise to Rand Brothers, Lansing, Mich., for \$4,000; one-half was paid in cash and one-half by a 30-day note.
7. Paid rent of building for month of November \$300.
10. A counterfeit \$5 bill was found among the cash.
12. Purchased a delivery car from Ford Motor Car Company, City, on account, \$550.
15. Received payment from D. K. Lee for merchandise sold to him on October 5. Check was for \$1,900 which was credited to his account and our refund check of \$100 mailed to him.
18. Sold merchandise to John K. Scott amounting to \$2,000, terms n/30.
20. The proprietor made an additional investment of \$2,000.

29. Paid salaries of office employees \$500.

30. Cash was short \$5.

(b) Summarize and rule the sales and purchase journals and the cash book.

(c) Post all of the entries.

(d) Take a trial balance.

CHAPTER XXIII

THE GENERAL JOURNAL

Purpose of Chapter.—

1. Content and use of the general journal.
2. Posting hints.
3. Special transactions.

Basis.—The student may inquire as to what principle governs the creation of special journals, that is, in a given business how many of these journals should there be? In analyzing the transactions of a business over a period, for example, a trading business, the student has learned that the transactions occurring most frequently are: the purchase of merchandise, the sale of merchandise, the receipt of cash, and the disbursement of cash. These accordingly give rise to the names of the journals in which it is customary to record them. We have, therefore, in such a business, a sales journal, a purchase journal, a cash receipts journal, and a cash disbursements journal. The same kind of analysis must be made to determine for every business the special journals that can be used to advantage. Therefore, the only principle that can be stated covering this point is that the number of transactions of the same kind occurring in a given business must determine the number of special journals. For example, if, as in the case of an automobile trading agency, it is customary to accept many notes from customers it would be a great saving of labor to use a notes receivable journal. Again, as in the real estate rental business, where many transactions involving the charging of rents to tenants take place, it would be advantageous to have a rent journal.

Content of the General Journal.—It must not be understood by what has been said above that there is one journal in which all transactions are recorded and that in addition to it there are the special journals. Such a method not only would not save labor but would make labor. The first and only record of each group of transactions is made in its special journal. There are naturally miscellaneous transactions which do not fall under any of these groups. These must be recorded in the journal, that is, the kind of journal first introduced in Chapter XIII. In such a journal both the debit and credit items of each transaction must be set up, because it is not limited to any particular class of transactions. Therefore it should now be evident that there is no longer one journal in which all the transactions are entered, but that the special journals and the miscellaneous journal, all taken together, comprise the journal record of the business.

The student has noted that a complete record of business transactions requires only a journal and a ledger. He has seen that this journal record may for the sake of saving labor be broken into as many separate journals as can be used advantageously. Therefore it is apparent that no general rule can be laid down governing the content of the general journal. This must depend on the number of special journals in use in any given business. The general journal will consequently not have a uniform content in all cases. The only working principle that can be stated is that those transactions for which special journals are not provided will be recorded in the general journal. Being a miscellaneous or sundry journal, its name, "General Journal," is appropriate.

Explanatory Matter.—In the special journals there is little need for explanation, because the very fact that a transaction is recorded in the special journal indicates its nature. Only necessary details, such as terms of sale, or terms of purchase, etc., should appear there. In the general journal, however, where many different kinds of transactions are recorded, a full explana-

tion of each transaction is necessary, so that at a later date, after the details have been forgotten, complete and intelligent understanding of the transaction can be secured from the record. The explanatory matter should, therefore, give all the essential details of the transaction. The explanation should not be long or wordy, but concise and brief. In case of doubt, however, the student should always err on the side of fulness, rather than of brevity.

Preventing Errors in Posting.—Bookkeepers have found that many of the errors in the ledger come from postings wrongly made from the general journal. Psychologists say this results from the inability of the mind to pass quickly from one kind of work or idea to another. When a bookkeeper posts a debit from the general journal, the record in the ledger must, of course, be made to the debit side of the account. If he immediately follows this debit posting by posting the credit side of the transaction, he must consciously pass from the debit side of one ledger account to the credit side of another ledger account. When doing this, particularly in a rush of work, it is easy to forget to change from one side of the ledger to the other, thus causing errors in the ledger.

Bookkeepers have found that such errors can largely be prevented by posting all the debits before posting any credits. In this way the constant, conscious effort of changing from one side of the ledger to the other is eliminated.

In a large measure this avoids errors in posting, a very important consideration as we shall see later, when discussing methods of detecting errors. As with sickness, so with ledger postings, prevention is better than cure.

Time of Posting.—There is no fixed practice as to the time for posting the general journal. Where it records adjustments with customers and creditors because of returned goods, allowances, etc., it is best to post it at the close of each day. In many cases

it is most convenient to post the previous day's records in the morning while the mail is being sorted and before work comes in from other sources. This leaves part of the morning and all the afternoon free for recording transactions.

The time for posting is a matter of office organization; a convenient time in one office might not be practicable in another. The student should make it a general rule to keep his posting right up to date. In this way he is sure that his ledger accounts with customers and creditors always show the exact amount due. Since posting is a mechanical operation, odd minutes may be utilized for posting from the various journals. Every item posted represents a task completed and correspondingly reduces the amount of posting to be done at the time the special journals are summarized.

Opening Entry Containing Cash.—The student is familiar with opening entries containing several assets and liabilities and understands that their debits and credits comprise the three elements of a balance sheet, namely, assets, liabilities, and capital. The proprietor will usually have some cash at the time of beginning operations. Cash, of course, is an asset and will appear among the debits to be entered in the ledger. Two courses are open if a cash book is in use: (1) All assets other than cash may be debited in the general journal, with a corresponding credit to Capital account. If the cash is entered in the cash book—receipts side—the effect will be a debit to cash and a credit to Capital. The two credits (general journal and Cash receipts) will then provide the total credit to the Capital account, making this a typical split transaction. (2) It is often desired to list all the assets (including Cash) in the general journal upon the opening of business. If this is done, it will provide the full credit to the Capital account. However, with a cash book in use, the item of Cash must also be entered in the cash book—receipts side—just as before. This, of course, duplicates the entry made in the general journal, because the amount of cash will be included in the

total cash receipts and the Capital account will be credited just as in (1). To prevent this duplication of debits to Cash from reaching the ledger, check (✓) the Cash debit in the general journal, and, since the Capital account has been credited in the general journal for the full amount of the investment (including cash), check (✓) the Capital account credit on the receipts side of the cash book.

To illustrate the manner of recording the opening entry when a cash book is used we shall show the same opening entry recorded under both plan 1 and plan 2.

Example: Assume that Edward Wright began business September 7, 19—, with cash \$2,000, merchandise \$7,000, and furniture and fixtures of \$1,000.

Omitting explanations, the entries to record this information would be as follows:

Plan 1

GENERAL JOURNAL

September 7, 19—			
Merchandise		7,000	—
Furniture & Fixtures		1,000	—
Edward Wright, Capital			8,000 —

CASH BOOK—RECEIPTS SIDE

19—				
Sept.	7	Edward Wright, C/a investment. See J. p. 1	2,000	—

Plan 2

GENERAL JOURNAL

September 7, 19—			
Cash (See C. B. 2)	✓	2,000	—
Merchandise		7,000	—
Furniture & Fixtures		1,000	—
Edward Wright, Capital			10,000 —

CASH BOOK—RECEIPTS SIDE

19—								
Sept.	7	Edward Wright, C/a	investment. See J. p. 1	✓	2,000	-		

If the assets with which the proprietor begins business consist of nothing but cash, it is convenient to record the item on the receipts side of the cash book only.

Transactions Involving Three Journals.—The split transaction, involving the use of two journals, was discussed and illustrated in Chapter XX and in the example just above. Sometimes, where special journals are in use, a transaction may involve three journals.

Example: Suppose that on September 10, 19—, you sold to Frank Morrison invoice #27, \$1,200, terms cash \$400, 30-day note \$600, and balance on account.

The full record will appear in three journals, viz., sales journal, cash book—receipts, and general journal.

SALES JOURNAL

(Page 17)

Date	No.	Customer	Address	Terms	F	Amount
19— Sept. 10	27	Frank Morrison	City	cash \$400; 30 da. note \$600; bal. on a/c	92	1,200 -

CASH BOOK—RECEIPTS

(Page 14)

19—							
Sept. 10		Frank Morrison	on a/c sale # 27	92	400	-	

GENERAL JOURNAL

(Page 8)

		September 10, 19—				
		Notes Receivable			600	-
		Frank Morrison		92		
		Rec'd 30-day note on a/c of sale # 27				600 -

The following account of Frank Morrison shows the full effect of the transaction.

FRANK MORRISON

(Page 92)

19—					19—				
Sept. 10		S 17	1,200	—	Sept. 10		C 14	400	—
					10		J 8	600	—

QUESTIONS

1. In a given business what governs the number of special journals?
2. Name some special journals other than sales, purchases, and cash.
3. What is a general journal?
4. Upon what does the content of the general journal depend?
5. In what way does the recording of explanatory matter in the general journal differ from the recording of such matter in the special journals?
6. Is the general journal summarized? Why?
7. What is the best method of posting the general journal? Why?
8. Upon what does the time of posting depend?
9. What is the advantage of keeping the posting up to date?
10. Explain two plans for recording the "opening entry" containing cash when a cash book is used.
11. If the proprietor begins business with nothing but cash, how should it be recorded?
12. Give an illustration of a sales transaction requiring the use of two journals. Three journals.
13. Give an illustration of a purchase transaction requiring the use of two journals. Three journals.
14. Assuming the use of a sales journal, purchase journal, and cash book, name and give the entry or entries for five different types of transactions that would be recorded in the general journal.

PROBLEMS

1. Write up a general journal for the following transactions assuming the use of a sales journal, purchase journal, and cash book:

October, 19—

1. Gave our note to L. T. Nates for \$3,000.
2. Returned purchases to Kelley-Springfield Company \$250.

3. Samuel Barnard advised us that some of the goods purchased from us were damaged in transportation. Knowing his word could be depended upon, we allowed him \$25, without return of the goods.
4. We had an open account against D. C. Copperfield of \$1,500, which he paid by giving us his 60-day note.
5. Gordon and Hauser returned merchandise to us as being unsatisfactory, \$75.
6. August Straub returned our statement of October 1 for \$200, stating he paid his account in September. Upon investigation we found an item of \$200 charged to his account which should have been charged to Thomas Straus.

2. (a) Enter the following transactions for a chemical supply business using sales and purchase journals, cash book, and general journal.

September, 19—

1. Abraham Jones started business with cash \$10,000; merchandise \$6,000; and an account against W. R. Littell, \$600.
 2. Bought merchandise from C. N. Young for cash \$3,000.
 3. Sold merchandise to Ernest Noles \$1,200, terms 2/10, n/30.
 5. Paid cash \$250 to M. L. Hicks for 1 month's rent.
 8. Sold merchandise to Harry Brown \$700, terms 2/10, n/30.
 10. Purchased merchandise from C. N. Young \$4,200, terms n/30.
 18. Received check from Ernest Noles paying for invoice of the 3d, \$1,200, with 2% discount deducted. Check was for \$1,176.
 21. Sold merchandise to Harry Brown, \$1,500, terms 2/10, n/30. Received from W. R. Littell a 30-day note for \$600 in full of account.
 25. Sold old packing cases to Norris and Gates for cash \$6.
 26. Purchased merchandise from C. N. Young, \$1,500, terms n/30.
 30. Paid salaries to office employees in cash, \$400.
- (b) Summarize the special journals and balance (close) the cash book.
(c) Post all of the entries on ledger paper.
(d) Take a trial balance.

3. (a) Journalize the following transactions using general, sales, and purchase journals and cash book.

December, 19—

1. John Henry French started a cotton goods business with \$10,000 in cash. He owed C. F. Crooks, on account, \$900.

2. Bought merchandise from D. C. Masters \$3,500, terms 2/20, n/30.
4. Sold merchandise to H. C. House \$1,000, terms 2/10, n/30.
5. Sold merchandise to L. Z. Emmert \$1,400, terms n/10.
7. Paid C. F. Crooks in full of account \$900 in cash.
9. Returned merchandise to D. C. Masters as being unsatisfactory \$500.
12. Received cash from H. C. House paying his account of \$1,000, less 2% discount.
14. Paid on account of daughter's tuition at Vassar College \$200.
18. Sold merchandise to J. G. Webster, on account, \$800.
20. Bought merchandise from D. C. Masters \$2,000, terms 2/10, n/30.
23. Paid account of D. C. Masters \$3,000, less 2%.
27. Paid gas bill in cash \$12.
31. L. Z. Emmert paid one-half of his account in cash \$700, and gave a 30-day note for the remaining \$700.

(b) Summarize the special journals and balance the cash book.

(c) On ledger paper post all of the entries.

(d) Take a trial balance.

4. (a) Journalize the following transactions, using general, sales and purchase journals, and cash book.

January, 19—

1. H. W. Speer began a business dealing in gas and electric fixtures with cash \$4,000; merchandise \$5,200; account against John N. Avery \$200; owed to B. C. Murdock on note \$1,200.
2. Sold merchandise to Pickering Brothers, on account, \$1,400, terms 2/40, n/60.
3. Received check from John N. Avery in full of his account, \$200. Bought of H. D. Folsom \$1,500 in merchandise, terms 2/10, n/30.
4. Paid drayage bills on incoming merchandise in cash \$24.
5. Sold merchandise to W. R. Baxter, on account, \$2,250, terms 2/10, n/30.
6. Received a 30-day note from Pickering Brothers for invoice of 1/2/—, \$1,400, less 2%.
8. Cash short \$5.
9. Paid salary to M. F. Friend \$50, Mary K. Roper \$25, L. T. Burk \$30.
10. Bought merchandise from Davis Patterson \$750, terms n/30.

11. Received check from W. R. Baxter for invoice of $1/5/-$, \$2,000, less 2%. Remainder of goods returned as not being needed, \$250. Total of check \$1,960.
12. Paid \$10 for postage stamps. Gave H. D. Folsom check for \$1,470 in full for invoice of $1/3/-$.
- (b) Summarize the special journals and balance the cash book.
- (c) Using two pages of ledger paper, post all of the entries.
- (d) Take a trial balance.
- (e) Assuming that all the expense assets have been consumed and that there is a merchandise inventory of \$3,500, prepare:
 1. Balance sheet
 2. Statement of profit and loss
- (f) Write the closing journal entries and post.
- (g) Close the ledger and take post-closing trial balance.
5. (a) Journalize the following transactions, using general, sales, and purchase journals, and cash book.

July, 19—

1. L. C. Downs began a retail hardware business with cash \$2,500, merchandise \$4,000, furniture and fixtures \$1,000. Bought merchandise from Joseph Whitson \$5,200, terms n/60. Bought office safe from Ironclad Safe Company for cash \$500.
2. Received cash \$45 for an old office desk.
3. Sold merchandise to Edward Mitchell \$3,500, terms 2/10, n/30.
4. Bought 10 shares of Lightning Express Company Stock at \$102 for cash.
5. Lent cash to Calvin Storms on his 30-day note \$500.
6. Sold merchandise to James Hadigan and Sons, on account, \$800.
7. Bought merchandise from Simkins Hardware Company, giving 10-day note in payment, \$5,000.
8. James Hadigan and Sons advised that the goods billed to them on July 6 amounting to \$800 were not purchased by them. Goods should have been billed to J. M. Haddon and Company.
10. Received payment from Edward Mitchell for invoice of July 3, \$3,500, less 2%.
12. Received 60-day note for \$808 from J. M. Haddon and Company, paying their account of \$800 with interest of \$8 included in face of note.
15. Paid clerks' salaries in cash, \$300.

- (b) Summarize the special journals and balance, or close, the cash book.
- (c) Using two pages of ledger paper, post all of the entries.
- (d) Take a trial balance.
- (e) With the following additional information prepare:

- 1. Balance sheet
- 2. Profit and loss statement

Additional information: merchandise inventory \$6,300; all expense assets have been consumed, together with \$150 accrued rent.

- (f) Write the closing journal entries and post.
- (g) Close the ledger and take a post-closing trial balance.

6. (a) Journalize the following transactions using general, sales, and purchase journals, and cash book.

February, 19—

- 1. John C. Carruthers who is engaged in the furniture business has cash of \$5,000; merchandise \$7,200; and furniture and fixtures for use in his office \$1,500; Newton T. Baker owes him, on account, \$1,500. He owes Northern Furniture Company, on account, \$1,200.
- 2. Purchased merchandise from Forbell Brothers \$3,800, terms 2/10, n/60. Gave Brown and Green check for rent for February \$400.
- 3. Received cash from Newton T. Baker, on account, \$750.
- 5. Paid his account with Northern Furniture Company \$1,200, less 2% cash discount.
- 7. A counterfeit \$10 bill was found in the cash register.
- 8. Paid tailor's bill for Mr. Carruthers \$138.
- 9. Paid salaries of office employees \$400.
- 10. Sold merchandise to Colonial Sales Company \$3,950, terms 2/10, n/60
- 12. Paid account with Forbell Brothers for bill of 2/2/—. Amount of check \$3,724.
- 13. Purchased merchandise from Zuckerman and Berger for cash \$2,250.
- 14. Received check for the balance of Mr. Baker's account, \$750. Paid Howe and Company by check for rent for the month of February \$400.

(b) Summarize the special journals and balance the cash book.

(c) Post to the ledger. Allow lines as follows: Cash 4, Merchandise Inventory 5, Furniture and Fixtures 5, Newton T. Baker 5, Northern Furniture Co. 3, Merchandise Purchases 4, Forbell Bros. 4, Sales Discount

5, Cash Short and Over 3, Purchase Discount 4, Salaries 6, Merchandise Sales 4, Colonial Sales Co. 4, Zuckerman and Berger 4, Rent 4, Merchandise Trading 15, Profit and Loss 10, John C. Carruthers, Personal 6, John C. Carruthers, Capital 8.

(d) Take a trial balance.

(e) With the following additional information prepare:

1. Balance sheet for February 14, 19—.

2. Statement of profit and loss

Additional information: merchandise inventory \$9,300; rent prepaid \$200; furniture and fixtures decreased \$30 on account of use.

(f) Write the closing journal entries and post.

(g) Close the ledger and take post-closing trial balance.

7. (a) The following transactions represent a continuation of Problem 6. Use the same journals and cash book.

February, 19—

16. Sold merchandise to Eagle Furniture Store \$3,500, terms 2/10, n/60.

17. Bought merchandise from Forbell Brothers \$3,700, terms 2/10, n/30.

19. Paid cash for telephone service \$15.

20. Received check from Colonial Sales Company, paying for sale of 2/10/—, \$3,950, less 2%.

22. Purchased merchandise from Zuckerman and Berger \$2,000, terms n/30.

23. Paid salaries of office employees \$300. Received check from Eagle Furniture Store for sale of 2/16/—, less 2%.

24. Sold merchandise to Colonial Sales Company \$4,000 and took their 30-day note in payment therefor.

26. Paid Forbell Brothers by check for invoice of 2/17/—, less 2%.

27. Mr. Carruthers took furniture amounting to \$800 for use in his home.

28. Donated \$75 to American Red Cross.

(b) Summarize the special journals and balance the cash book.

(c) Post to the same ledger as used in Problem 6. Open the following additional accounts: Eagle Furniture Co. 3, Notes Receivable 3, Telephone 3, Donations 3.

(d) Take a trial balance.

(e) Additional information: Merchandise inventory \$8,500. All expense assets were consumed. Furniture and fixtures decrease in value \$30. Accrued salaries \$100.

Prepare:

1. Balance sheet
2. Statement of profit and loss

(f) Write the closing journal entries and post.

(g) Take post-closing trial balance.

(h) Make comparative balance sheet for February 14 and February 28, 19—.

8. (a) Enter the following transactions, using purchase and sales journal, cash book, and general journal.

October, 19—

1. Harvey C. Bowser started a china and glassware business with the following assets and liabilities: cash \$5,000, land and building \$20,000, furniture and fixtures \$1,000, merchandise \$10,000, Harry N. Sheffield owes on account \$1,600, Frank L. Davis owes on a 60-day note \$1,200, owed to John D. Meyers and Company, on account, \$2,000.
4. Paid Cohen and Company \$60 for office supplies and stationery.
5. Sold merchandise to Taber and Company for \$5,200, terms 2/10, n/60.
7. Sold merchandise to Harry N. Sheffield \$4,000, terms 2/10, n/30.
10. Received payment from Frank L. Davis for \$1,200 note due today with 5% interest. Total \$1,210.
12. Bought merchandise from John D. Meyers and Company \$2,500, terms 2/20, n/60.
15. \$200 was stolen from the cashier while he was on his way to the bank. Received check for \$5,096 from Taber and Company for sale of 10/5/—, \$5,200, less 2%.
17. Paid John D. Meyers and Company for item of October 1, \$2,000 less 2% cash discount.
27. While Mrs. Bowser was out of the city she telegraphed for some money. The cashier sent her \$150.
30. Paid salaries to office employees \$400, to salesmen \$300 for salaries and \$200 for traveling expenses.
31. Some of the merchandise purchased from John D. Meyers and Company on October 12 was damaged, for which they made an allowance of \$100 to us.

(b) Summarize the special journals and balance the cash book.

(c) Post to the ledger. Two pages of ledger paper are required. Open accounts and allow the following number of lines: Cash 3, Merchandise

Inventory 3, Furniture and Fixtures 5, Land and Building 3, Notes Receivable 3, Harry N. Sheffield 3, Taber and Company 3, John D. Meyers and Co. 4, Merchandise Purchases 4, Merchandise Sales 3, Sales Discount 3, Salaries 4, Salesmen's Traveling Expenses 3, Purchase Discount 3, Rent Income 3, Harvey C. Bowser, Drawing 3, Harvey C. Bowser, Capital 6, Merchandise Trading 8, Profit and Loss 8, Taxes 3.

(d) Take a trial balance.

(e) Prepare:

1. Balance sheet

2. Statement of profit and loss

(f) Write the closing journal entries and post and close the ledger.

(g) Take post-closing trial balance.

Additional information: Merchandise inventory \$5,000. Expense assets of \$40 were consumed together with \$10 of the furniture and fixtures. Rent income accrued for part of building rented to J. C. Nobbs, \$100. Taxes accrued \$150.

CHAPTER XXIV

BUSINESS PAPERS—THE GOODS INVOICE

Purpose of Chapter.—

1. Form and content of the goods invoice.
2. Handling of purchase orders and invoices.
3. Handling of sales orders and invoices.

Business Papers.—The student now has a complete picture of the formal accounting records. All that is necessary is a journal and a ledger. These are fundamental and on them rest whatever other records may be kept. However, the question has no doubt arisen in the student's mind as to how the bookkeeper gets all the information necessary for making the entries on his books. It is manifestly impossible, except in the smallest enterprises, for each employee to record on the books the transactions which he has carried out.

As the business grows, it becomes necessary to subdivide the duties of the employees. Various records become increasingly necessary in order to inform those in charge of what the departments and even the employees are doing. When the business is small and the employees are in constant touch with each other, no elaborate reporting routine is necessary. As a business becomes larger, the method of reporting becomes a vital part of the organization. These reports, whether formal or informal, are called **business memoranda** or **business papers**. They serve several purposes, the chief of which is to provide the bookkeeper with a record of all transactions throughout the establishment. Only in this way can he make a complete diary of the business and so be able to supply the owner with a picture of his business for the purpose of maintaining adequate control. The more common

and important business papers will be discussed in this and following chapters.

Necessity for an Invoice.—A goods **invoice** (Form 12), is a memorandum record of a purchase or sale of goods, including all the detail necessary to enable the bookkeeper to record the transaction properly. A sale of goods from one standpoint is a purchase from the standpoint of the other party to the transaction. Goods which prove unsatisfactory and are returned will be entered on a memorandum, also spoken of as an invoice. The memorandum record of the receipt or issue of goods, whether formal or informal, constitutes a goods invoice.

Content of the Goods Invoice.—The following information should be given in the goods invoice:

1. Date of transaction.
2. Parties to transaction.
3. Terms of sale or purchase.
4. Description of articles bought or sold.
5. Price or amount of purchase or sale.

1. *Date.* The exact date of a transaction is important as a matter of record. The invoice forms (see Form 13) show how provision is made for this.

2. *Parties.* The names of the buyer and the seller must be indicated. It is customary for the seller to have his name, address, and business appear prominently at the head of the invoice. This has a certain advertising value and should never be overlooked in designing a sales invoice form. It is printed in whatever ornate way suits the merchant's fancy. It is equally important that the name and address of the buyer appear. The bookkeeper must have the name of the party to whom the goods are sold in order to make his bookkeeping record. The address is also necessary both for his delivery of the goods and for the conduct of correspondence.

3. *Terms.* Goods are sold on two bases: (1) cash, and (2) time. The term "cash" is used in two ways. A cash sale is usually understood to mean that cash accompanies the order and that the transaction is settled completely when the goods are purchased, such as the ordinary cash sale at a retail store. However, often in the wholesale trade, terms of sale are also spoken of as "cash" when settlement must be made within a short time, usually 2 to 5 days from the date of purchase. Sometimes, if payment is to be made in 10 days, it is classed as a cash sale—terms, cash in 10 days, or cash.

SOPH MANUFACTURING COMPANY, INC.

LEATHER GOODS

317 BROADWAY

NEW YORK, 10/3/1921 19

SOLD TO McAndless Bros. & Jarvis

321 S. Canal Street, Chicago.

TERMS 2/10, n/30

TELEPHONE ORCHARD 1704

4	#725 A Wardrobe Trunks				
	@ \$35.-	140	-		
12	#369 C Steamers				
	@ \$13.50	162	-		
24	#135 Suit Cases 26"				
	@ \$8.25	198	-		
6	# 79 English Kit Bags 24"				
	@ \$20.15	120	90		
				620	90

Time sales are of two main kinds also: (1) those on which no discount is given, and (2) those on which a discount is given. Goods are always sold on time or credit with the expectation that payment will be made within a definite time. The invoice invariably states the date on which payment will be expected. Thus, goods may be sold "net 30 days," abbreviated $n/30$, meaning that the seller expects the buyer to pay the net amount of the invoice within 30 days, no deduction from that amount being allowed. More frequently, however, a deduction from the gross amount of the invoice is allowed if payment is made earlier than the full credit term. This really means that two bases of settlement are allowed the buyer. Thus, if goods are sold "net 60, or 2% discount if paid in 10 days"—abbreviated as " $n/60, 2/10$ "—the buyer is given an optional basis of settlement. He may withhold payment of the gross amount for 60 days or he may deduct 2% from this amount if he pays within 10 days.

This information as to when the merchant may expect payment for the goods is vital to the successful conduct of the business. He must maintain at all times a sufficient fund of cash to meet his expenses and pay his bills. If he knows when he may expect payment from his customers, he can tell roughly how much cash he will have to provide for in other ways. It is therefore especially important that the terms of sale be indicated on the goods invoice. These terms vary greatly in different businesses. Sometimes 30 days is a normal or average time allowed customers to pay for their goods, while in other lines of business, such as the farm implement trade, as much as a year may be given. Practically all terms between these two extremes are found in business.

Occasionally one finds a delivery date on goods invoices. Traveling salesmen may go over their territory early in the year and sell goods to be delivered several months later. Orders may be taken for goods to be delivered 4 or 8 months from date, or on any other date agreed upon. These goods must often be manufactured before delivery can be made. An invoice may

thus contain two dates, namely, the date of the transaction and the date of the expected delivery. The terms of sale may involve still other dates when payment of the invoice will be expected.

Entering on an invoice a later date from which the time for payment is counted is called **dating** or **extra dating**.

The American Woolen Company invoice (Form 13, page 378) is dated January 26, but for the purpose of payment the time is counted from June 1. This date is found in the "terms" which are interpreted as follows: Counting June 1 as the invoice date, "7/4" means 7% discount for payment in 4 months from June 1, and, similarly, the others mean 8%, 8½%, or 10% discount for payment in 60, 30, or 10 days respectively from June 1. In the terms of sale of the Fred L. Sayles Company invoice, the letters *com* mean "end of month," making it due 30 days from February 28, or March 30.

4. *Description of Articles.* It is, of course, essential that the invoice give a description of the articles bought and sold, covering the following points: (1) quantity sold, (2) name or kind of article, and (3) sales price per unit, if more than one unit is sold.

5. *Amount.* The amount of money involved is determined from the data as to quantity and price per unit. The amount for each article is extended into a column provided for that purpose, and the total amount is also shown. This work is called "making the extensions," that is, extending the amount obtained by multiplying the number of units by the price per unit for each article, and then showing the grand total of these amounts. In Chapter XVII the distinction between trade and cash discounts was explained. Where trade discounts are allowed, it is customary to show on the goods invoice the list price and to deduct from it the trade discounts or other allowances. The result will be the amount to be paid.

The goods invoice should contain all the terms of the sales contract between buyer and seller, in order to avoid later dispute or misunderstanding.

Form of the Goods Invoice.—There is no standard form of goods invoice, each business using the form best suited to its needs. Form 13 shows several forms of invoices, some simple, others complex, columns being provided for the different types of information required.

The Purchase Order.—The purchase of goods arises through an order, oral or written, which is the authority to the seller to send the goods in accordance with the specifications. Oral orders are given by spoken word either direct or over the telephone. Such an order is usually considered binding in law, but good business practice usually follows it with a letter of confirmation in which its terms are reduced to writing. A large volume of business is done by word of mouth, however, and between business houses that deal with each other constantly there is little difficulty in adjusting differences. To be legally binding, however, a written order should always be given, by telegraph, by letter or order blank, or by signing a salesman's order form as authority for sending the goods.

Usually no formal record is kept by the buyer of orders given by him. The formal record is made when the goods are received. Where a formal book is kept for recording all purchase orders, a stub or interleaf is used for keeping a memorandum record of the orders issued. If the order is in the form of a letter, the carbon copy of the letter serves as a memorandum of the goods ordered. If a salesman has secured the buyer's signature to an order, he leaves a carbon copy of it with the buyer. These purchase orders are sometimes called "commitments."

Receipt of Purchase Invoice.—As soon as the goods are shipped, the seller sends, usually by mail, an invoice covering the shipment. The buyer should hold this invoice until the goods arrive, as it contains full information as to the goods shipped. The buyer first compares it with his copy of the purchase order as to terms, articles, and amounts. The accuracy of the calcula-

tions and extensions may then be verified, each figure verified being indicated on the invoice by a check mark. More often verification is deferred until the invoice is compared with the goods received, when shortages can be noted and verification completed at one operation.

When the goods arrive the railroad company usually notifies the buyer, who sends for them. When they reach his place of business, he or his clerks examine them as to quality and quantity, comparing them with the purchase order and the invoice. Any differences between the order and the goods are noted on the order or the invoice. After taking account of the adjustments due to differences between goods ordered and goods received, the buyer determines the correct amount to be paid by him and places the invoice in a temporary file or folder to await its turn for payment. The invoices are often given a file number which may be the same as the number of the purchase order covering the transaction. Many different methods of filing and numbering are in use.

Record of Goods Received.—The record of goods bought is not usually made in the formal books of account until the goods have been received and the amount of the debt determined as indicated above. The manner of recording depends somewhat upon the terms of the purchase and may be indicated under several heads.

1. If the goods have been purchased on account, the record will be made in the purchase journal by a charge to Purchases account and a credit to the seller's account.

2. If the purchase was for cash, the record in the purchase journal will be the same as indicated under (1), but the cash disbursements journal will also record the cancellation of the debt by crediting Cash and debiting the seller's account. These two entries are contemporaneous, that is, made at the same time. If a discount is allowed for cash payment, the entry recording the charge to the seller's account and the credit to Purchase Discounts will be made in the general journal.

3. If payment is to be by note, the record of the goods received is made in the purchase journal and the record of the payment in the general journal, where the seller's account is charged and Notes Payable account credited.

4. If payment is made partly in cash and partly by note, the purchase journal will record the receipt of the goods, the cash disbursements journal the cash payment, and the general journal the payment by note.

5. If no payment is made at the time of the receipt of the goods, the invoice, after having been approved for payment and

Claims for errors or omissions must be reported within ten days or they will not be allowed.

THE VINDEX COMPANY

VINDEK DRESS SHIRTS
VINDEK FLANNEL SHIRTS
VINDEK UNDERWEAR

PRATT STREET & MARKET PLACE
BALTIMORE, MD.

LADIES' ATHLETICS
CHILDREN'S UNDERWEAR
CHILDREN'S SLEEPERS

BALTIMORE April 22, 1921. TERMS 2/10/60 or 3/10 NEW YORK OFFICE:
CHURCH & FRANKLIN STREETS

SOLD TO E. Baron,
168 Passaic St.,
ADDRESS Passaic, N.J.

All Bills not Paid at Maturity
Subject to Draft at Sight.

Canton SHIPPED AT PURCHASER'S RISK VIA Exp.

CASE NO.	LOT	DOZ	BOXES	SHIRTS	PRICE		
8913	ADV	2 6/12	5	UND	8 50	21 25	
	H6096Vo	3/12	1	V	30 00		
	H6379V9	3/12	1		35 50	15 88	37 13

Completes order of 4/12/21

PAID
JUN 29 1921
THE VINDEX CO.

REC'D
JUN 29 1921

NOTE: No returned goods accepted unless returned with our consent

We hereby guarantee that the garments covered by this invoice have been manufactured by us in accordance with the Federal Child Labor Act of September 1st, 1916.

Form 14. Receipted Invoice

entered in the purchase journal, will be held until the date of payment, when the payment will be recorded in the cash disbursements journal. The invoice will be marked "Paid," the

date of payment and often the number of the check by which payment was made being indicated, and then filed permanently, as distinguished from the temporary file in which it was held awaiting payment. If paid by note or part cash and part note on date of payment, the same procedure will be followed. It is not customary to send the invoice with the check for the purpose of obtaining a receipted bill. The canceled check which will be returned to the buyer constitutes a sufficient receipt. The form of paid invoice has been shown above (Form 14). Sometimes a separate receipt may be given by the seller, as illustrated in Form 15.

<i>Received of</i> _____ John B. Stevens	Albany, N.Y., Aug 10 1921
Two hundred sixty-seven & 29/100	<i>Dollars</i>
in full settlement of account to date.	
\$ 267 29/100	<i>George R. Christy</i>

Form 15. Separate Receipt Form

At the time the goods are taken from the railroad freight station, either the freight charges must be paid or a bill rendered by the railroad company showing the charges due. When the freight is paid, the entry is made in the cash disbursements journal charging Freight and Cartage Inward account and crediting Cash.

Routine of Sales Order.—Just as from the standpoint of the buyer a purchase order is issued when goods are purchased, so from the standpoint of the seller a sale usually arises as the result of the receipt from the buyer of a sales order, either oral or written. If oral, the seller usually makes a written copy of it in order

to reduce it to formal record and so aid in filing the order. Goods are sold "over the counter" as a result of the buyer's oral order. In many small retail establishments which sell only for cash, no formal record is made of sales other than the amounts recorded on the cash register. In the larger retail stores, however, the salesmen make written copies of all sales orders, which constitute the sales invoices.

In wholesale and jobbing establishments sales orders are almost invariably written. They may be in the form of a letter or telegram sent by the customer. This order is usually copied by order clerks onto a formal house order form. Frequently separate departmental orders are made and sent to the departments concerned in filling the order, the goods being finally brought together in the shipping-room for packing and forwarding to the customer.

Some firms keep their customers supplied with their own order blanks so that copying is eliminated, although some houses even recopy these orders to detect possible errors. The order is then sent to the various department stock clerks for filling. The goods are selected and packed in the department or sent to the shipping department for packing. As the goods of an order come into the shipping department from the various departments, they will be assembled, packed, and the package addressed in accordance with instructions given by the customer or firm. A shipping order will be issued to the delivery service, either the house's own service or independent service, indicating route and method of shipment. The package as finally prepared for shipment often contains in addition to the customer's name and address a register and bale or case number. These matters vary in different concerns and trades in accordance with the commodity dealt in. The sales order is then filed, usually with the customer's letter, to serve as reference in case of question.

The Sales Invoice.—The sales order may be used for the preparation of the sales invoice. Since the stock clerks check

off the items on the order blank as they fill the order, when the blanks reach the office full information as to the commodities shipped is available, and the billing clerk can make out the customer's invoice. This invoice contains the same kind of information as the purchase invoice, and is usually made in duplicate or triplicate. The original goes to the customer as notice that the goods have been shipped. The duplicate serves as a basis for the entry on the books of record.

The Retail Sales Order and Invoice.—The sales order routine in a retail establishment differs from that in a wholesale establishment. The sales order, usually verbal, is reduced to writing by the salesman receiving it. This almost invariably constitutes also the sales invoice or bill. The sales ticket used by most retail establishments is an informal invoice. The routine of handling it depends on the internal organization of the business.

Two differently colored invoices are often used, one for cash and one for credit sales. The invoices are made out in duplicate or triplicate, the original going with the goods to the customer. This one is often first sent with the goods to the wrapping desk, where the quantities or measures are checked before the goods are wrapped, the package ultimately finding its way over the counter or by way of delivery service to the customer. The duplicate of the cash invoice goes to the cashier or cash cage with the customer's money and provides a basis for making change or checking the amount of cash accompanying the invoice. At the close of the day the sales tickets held by the cashier are used for proving the cash received. The cash received in the morning for making change plus the invoices in the cage at night must equal the amount of cash in the cage. In the case of credit sales the original ticket goes with the goods to the customer, while the duplicate goes to the bookkeeping department to serve as a basis for the charge to the customer's account.

Methods of Shipping Goods.—Goods may be delivered or shipped by parcel post, express, freight—railroad or steamship—or by truck—an independent trucking company or the house's own delivery service. When goods are shipped **f. o. b. shipping point**, it means that they are placed free on board cars or ship. When goods are shipped **f. o. b. destination**, the seller pays the freight. However, prepaid freight may be at the customer's expense, in which event, although paid by the seller, it is charged against the customer and collected from him. Goods are frequently sent C.O.D., that is, cash on delivery. The purchaser cannot get the goods until he pays for them.

Bill of Lading.—When the goods are delivered to the carrier, a receipt is made out. In the case of express shipments this is called an **express receipt** (Form 16). In the case of freight

AMERICAN RAILWAY EXPRESS CO. (INCORPORATED)		NOTE
Original Uniform Express Receipt	COLLECT L 508700	The Company will not pay over \$50, in case of loss, or 50 cents per pound, actual weight, for any shipment in excess of 100 pounds, unless a greater value is declared and charges for such greater value paid. The Company's charge, except upon ordinary live stock, is dependent upon the value of the property, as declared or released by the shipper. If the shipper desires to release the value to \$50 for any shipment of 100 pounds or less, or not exceeding fifty cents per pound, actual weight, for any shipment in excess of 100 pounds, the value may be released by inserting "not exceeding \$50," or "not exceeding fifty cents per pound," in which case the Company's liability is limited to an amount not exceeding the value so declared or released.
NON-NEGOTIABLE		
Issued at New York, N. Y., _____ 192__		
Received from _____		
Address _____ Subject to the Classifications and Tariffs in Effect on Date of Issue		
Article _____ Weight _____		
Consigned to _____		
At _____ (Number) (Street)		
Value herein declared by Shipper to be _____ (City) (State)		
Dollars.		
Which the Company agrees to carry upon the terms and conditions printed on the inside front cover hereof, to which the shipper agrees, and as evidence thereof, accepts and signs this receipt.		
Shipped _____		
Per _____	For the Company _____	

Form 16. Express Receipt

shipments, it is called a **bill of lading**. There are two kinds of bills of lading, the straight and the order. The straight bill

will be explained here, the order bill on page 467. In addition to being a receipt, the bill of lading is a contract between the shipper and the carrier for the transportation of goods, and as such contains the conditions under which the goods are accepted for shipment. The bill of lading, by act of Congress in 1908, was made uniform in content and size. It is made out, either by the carrier or the shipper, in sets of three (see Form 17), the first the original, the second the shipping order, and the third, the memorandum. The shipping order is signed only by the shipper and is retained by the carrier. It gives the carrier authority for shipping the goods and binds the shipper to the terms of the contract signed by him. The memorandum and the original are signed by both shipper and carrier. The memorandum is merely an "acknowledgment that a bill of lading has been issued, etc." and is for the shipper's file. The original is the full contract entered into and should be sent to the customer or consignee. Careful note should be made of the content and the way in which the bill of lading is drawn up. Most shipments are made on the straight bill of lading, which is not negotiable.

Bookkeeping Record of the Sales Invoice.—The sales invoice is the basis for the entry in the sales journal, from which it may be posted as a charge to the customer's account. Where the modern sales journal is used, only a single line is given to each item. The customer's account may be posted from the sales journal or, more frequently, from the duplicate sales invoice, after which the invoice goes into the permanent file. A sale always involves a debit to the customer and a credit to Sales. The record of the payment depends on the terms. Sales may be for cash or credit. A customer may give his note or there may be part cash payment, part note, with balance on account. If cash is received, it must be recorded in the cash receipts journal. If a note is received, it must be recorded in the general journal, the procedure being similar to that followed in the case of the purchase invoice. When the customer pays his account, where

the sale has been for credit, if a sales discount is taken, the discount will be recorded either in the general journal or cash book.

Credit Memorandum.—The credit memorandum (Form 18) is a goods invoice indicating a credit allowed a customer because

CREDIT MEMORANDUM FROM THE BROUN-GREEN COMPANY 48 JOHN ST., NEW YORK.		APPROVED F. L. B.	
NAME Henry Davidson		LEDGER S.1	
ADDRESS 411 Main Street, Buffalo, N Y			
WE CREDIT YOUR ACCOUNT FROM INVOICE OF		Jan. 4, 1921 AS FOLLOWS:	
Jan 18	To correct overcharge in pricing 20 M envelopes " 1 Binder # 37 A. returned	10.50 .75	11.25

Form 18. Credit Memorandum

of an adjustment made after the sale and the sending of the original invoice. These adjustments or allowances arise from:

1. Goods returned by the customer.
2. Damaged goods or goods not up to standard in quality.
3. Shortages, that is, less goods received by the customer than was charged on his bill.
4. Clerical errors in price or in the extensions of the invoice.

The credit memorandum is similar to the sales invoice in that it must give practically the same information as to buyer and seller, and the amount and nature of the allowance. To distinguish the credit memo from the regular sales invoice, a different color of paper is often used, preferably red or pink.

On the books the credit memo has exactly the opposite effect to the sales invoice. On the customer's books the transaction is a charge against the seller and a credit to Purchases or Purchase Returns and Allowances, where such an account is kept. On the seller's books the transaction is a debit to Sales or to Sales

Returns and Allowances, where such an account is kept, and a credit to the customer's account offsetting the original charge made at the time of the sale.

The Monthly Statement of Account.—Where goods are sold on credit and accounts opened with customers, it is the practice to send the customer a statement of his account at least monthly.

STATEMENT									
L. H. BIGLOW & COMPANY, INC.,									
PRINTING-STATIONERS									
24 BEAVER STREET									
FOLIO. <u>175</u>					NEW YORK.				
R. C. Coombs & Co., Inc.,									
27 Jackson Pl.,									
Newark,									
N. J.									
ACCOUNTS ARE DUE UPON PRESENTATION OF BILL									
9/30	Balance							25	40
10/3	TO MERCHANDISE AS PER BILLS RENDERED					10	05		
8	" " " " " "					79	80		
27	" " " " " "					106	75	196	60
								222	--
	Credits								
10/2	Cash					25	40		
10/12	Allowance, inv. 10/8					4	20		
10/15	Cash					85	68	115	25
10/31	Balance due							106	75

This affords him an opportunity to compare the statement with his records and permits corrections to be readily made. It also serves as a request for the amounts due or past due. The statement is not a sales invoice but a summary or detailed statement of dealings with the customer during the past month. In some concerns the details of all purchases made, of all goods returned, and of all cash or notes paid by the customer, are set forth in this statement. More often, however, only a summary of the transactions is shown. In this case the statement is practically a transcript of the customer's ledger account, showing the balance due at the beginning of the month, the debits and credits entered during the month, and the balance due at the end of the month. Form 19 indicates the nature of the monthly statement.

The customer's ledger account as kept by the seller should indicate in the explanation column the dates on which monthly statements are sent to customer. This is a part of the history of the concern's dealings with its customers and should be a matter of record.

QUESTIONS

1. What are the basic records in any bookkeeping system?
2. How does the bookkeeper get the necessary information for making his record?
3. What is a goods invoice? Does the term include both sales and purchases and returned goods also?
4. What five kinds of information should the goods invoice contain? Explain the importance of each.
5. What do you understand by a cash sale? A credit sale?
6. How are terms of sale usually stated? Give an example.
7. How is the gross amount of the invoice found?
8. How is the net amount of the invoice found?
9. Distinguish between the purchase order and the purchase invoice. What is the purpose of the purchase order?
10. What are commitments?
11. Explain fully the use made of the purchase invoice by the buyer:
 - (a) When first received through the mails.
 - (b) When the goods arrive.
 - (c) When payment is made.

12. Explain fully the record made of goods received when purchased:
 - (a) On account.
 - (b) For cash.
 - (c) By note.
 - (d) Part payment by cash or note.
13. When is an invoice filed temporarily? When permanently?
14. How is a receipt obtained for payment of an invoice?
15. What entry is made for the payment of freight?
16. Explain the use made of a sales order in a retail store.
17. Explain the use made of a sales order in a wholesale store.
18. Trace a sale from the time the order is received to the time of shipment or delivery.
19. How is the sales invoice made up? What does it contain? What use is made of it?
20. Explain fully the routine of the sales order or invoice in a retail store. Show its uses both for cash and credit sales.
21. In what different ways are goods shipped?
22. What is an express receipt? A bill of lading?
23. What information does the bill of lading contain?
24. Give the names and uses of the three copies made of the bill of lading.
25. What signatures are attached to the different copies?
26. Explain the bookkeeping records made from the sales invoice under the various terms of sale.
27. What is a credit memorandum? Out of what kinds of transactions does it arise?
28. What bookkeeping record is made of a sales credit memo? A purchase credit memo?
29. What is the purpose of the monthly statement of account? What information does it contain?
30. Is any bookkeeping record made of the monthly statement of account, either when issued or when received?

PROBLEMS¹

1. On June 25 another shipment of hardware is made to the Hardware Specialties Company, amounting to \$254.25. The balance owed to

¹ Note to Instructors: Start the student at once on Problem 14, a series of transactions—running through four chapters—to be recorded in the bound blank books provided. This and the subsequent similar problems of later chapters are chiefly for review and should in the main be worked up by the student independently. The other problems are to accompany the text of the chapter and should be assigned as the text matter is developed.

Sargent and Company by the Hardware Specialties Company on June 1 amounted to \$425 50. This was paid on June 6, less 2%. The Hardware Specialties Company pays the June account on July 5, less 2% and requests that the receipted statement be returned.

(a) Prepare the monthly statement to be sent to the Hardware Specialties Company on July 1.

(b) Receipt the statement.

2. On March 3, 19—, George T. Brodnax, Inc., of Memphis, Tenn., receives the following order from George Anderson of Detroit, Mich., to be sent C. O. D., American Railway Express:

1 Electrolier #22146 at	\$ 20—
1 Sterling Silver Dinner Set #27982 at	500—
1 Set Sterling Silver Tableware Livingston design #27880 at	499—

Prepare the invoice.

3. On August 3, 19—, The Florsheim Shoe Company of Chicago shipped the following by express to the Addison Shoe Store of Poughkeepsie, N. Y.:

Factory No.	Case No.	Pairs		Width	Last	Price
61739	1	24	All Rajah C. F. Bal. 80	D	Saranac at	\$11 —
61710	3	24	" " " " "	D	Rainbow "	11 —
61712	2	24	" " " " "	D	Ormond "	11.55

Terms: October 1, 19—, 2/10, n/60.

Prepare the invoice.

4. The Vindex Company of Pratt St. and Market Pl., Baltimore, Md., ships the following by express on April 22, 19—, to Madame A. Ferrar, proprietor of the Ladies Waist and Corset Shop, of Asbury Park, N. J.:

Lot	Doz.	Boxes	
HDV	2 1/2	5	Underwear at \$ 8.50 per doz.
H6096V9	3/12	1	V. Shirts " 30.00 " "
H6379V9	3/12	1	" " " 33.50 " "

Terms: 2/10, n/60.

Prepare the invoice.

5. The following purchase order is received on June 4 by Sargent and Company where the order is transferred to their regular order slips, a copy of which is sent to the shipping department. The latter informs the billing department that the 120 sets of locks and the butts are to be sent from factory located at New Haven, Conn., while the remainder of the order is

PURCHASE ORDER

No. 1253

Date June 3, 19—

HARDWARE SPECIALTIES COMPANY,

POINIER ST. & AVENUE A.,
NEWARK, NEW JERSEY.To Sargent and Company,
Address 94 Centre St., New York City.You are hereby authorized to furnish the following material to be shipped via
Pennsylvania R.R. terms 2/30, n/60.

Quantity	Descriptions		Price	Discount
120 Sets	Locks	R7D344TSH*	.83	
24 Doz.	Butts	Da 2431--3 1/2 x 3 1/2* per set	2.64	
2 "	Transom Lifters	253*--5 ft. " " per doz.	11.28	1/3-25
12 "	Rim Locks #2213	" " " "	2.76	
1 "	Disston Saws	12-26 in.--#8* " " "	42.40	
4 "	Nicholson Double End Files #8*	" " " "	3.90	50-5
1 "	Hammers #11	" " " "	13.85}	10
1 "	" #11 1/2*	" " " "	13.12}	
50 Boxes	Tire Bolts	1/4" x 2" " box	1.05}	65-10
50 "	"	1/4" x 2 1/2" " "	1.10}	

Kindly acknowledge receipt of this order, and place above order number on all packages and invoices.

* These are catalogue numbers.

Signature *Andrew Cummings, Purchasing Agent.*

being shipped from stock. Shipment is made on June 10, consisting of two cases of rim locks weighing 156# and two cases of miscellaneous hardware, weighing 407#.

Prepare the invoice to be sent to the Hardware Specialties Company for the goods that are being sent from stock and show how the bill of lading would be prepared.

6. On June 17 the New York office of Sargent and Company is informed that the remainder of the order has been shipped from New Haven by the Pennsylvania Railroad Company. The shipment consists of two cases of locks weighing 240# and two cases of butts weighing 360#. Prepare the invoice and bill of lading.

7. On June 20 the Hardware Specialties Company returns the following guaranteed products which are accepted by Sargent and Company.

$\frac{1}{2}$ Doz. Hammers #11 at \$12.46 per doz.
 $\frac{1}{4}$ " Hatchets #232 at 15.32 " "

Prepare the credit invoice.

8. The following articles were returned to Samstag and Hilder Brothers, importers and manufacturers, Broadway and 29 St., New York City, by H. Witherspoon, proprietor of the Cute Notion Shop, Saratoga Springs, N. Y.:

Lot No.

4/6440	$\frac{1}{2}$ Doz. Necklaces at \$4 - per doz.	
3565	$\frac{1}{4}$ " " " 8 - " "	
2510	$\frac{1}{4}$ " " " 8.50 " "	} less 5%
2515	$\frac{1}{4}$ " " " 8.50 " "	

(a) Prepare the credit invoice.

(b) Give the entry for Samstag & Hilder Brothers.

(c) Give Witherspoon's entry.

9. On June 15, 19—, the American Chair Manufacturing Company of Halstead, Pa., makers of living-room, library, hall, den, chamber, desk and reception chairs, ships the following to the Globe Furniture Company of Troy, N. Y., by the American Railway Express:

2—131 $\frac{1}{2}$ S. W. Chairs at \$ 8.40 per chair	
2— 61 $\frac{1}{2}$ B. E. " " 7.65 " "	
2—130 $\frac{1}{2}$ A. W. " " 7.40 " "	
1—120 " " " " 10.40 " "	
1—120 $\frac{1}{4}$ " " " " 9.65 " "	
1—120 $\frac{1}{2}$ " " " " 9.65 " "	

Terms: 2/30, n/60. F. O. B. Factory. Weight of shipment, 114 lb. Express collect.

(a) Prepare the invoice.

(b) Prepare the express receipt.

10. James Arnold of St. Louis, Mo., proprietor of a retail dry-goods store, has made the following purchases during the month of May, 19—, from Butler Brothers, Kansas City, Mo., wholesalers of general merchandise:

May	Amount
-----	--------

5	\$146.25
---	----------

15	75.66
----	-------

20	56.75
----	-------

25	87.73
----	-------

On May 18 he returned merchandise to the value of \$25.43 and on May 25 was allowed \$7.63 due to overcharges on certain items of May 15 shipment.

Terms of sale: 2/10, 1/30, n/60.

Prepare the monthly statement to be sent to James Arnold on June 1.

11. On June 7 James Arnold pays his May account, less a cash discount of 1%.

(a) Show the receipted statement.

(b) Give Arnold's entry at date of payment.

(c) Give Butler Brothers' entry when they receive check.

12. On July 1, 19—, R. C. Adams sends a check for \$250 to the Curtis Realty Company of New York City, to cover his rent bill for July.

Prepare the rent receipt.

13. On June 10, 19—, R. B. Kings sends a check for \$350 to the Spencer V. Bartlett Company, of Chicago, as a payment, on account for merchandise received on June 9.

Prepare the receipt.

14. A series of transactions is to be recorded in blank books provided.

You have been engaged as bookkeeper by Mr. Thatcher in place of Mr. Bright, the former bookkeeper, who has been promoted to manager. Mr. Bright finds that his whole time must be given to his new duties therefore you will be required to close the books without his assistance. Mr. Thatcher closes his books at the end of every 3 months (quarterly) and requires a trial balance at the end of each month. Below are given a trial

balance and additional information from which the books are to be closed Proceed with the quarterly closing as follows:

(a) Use the bound blank books provided in the stationery—the journals and the ledger. Set up the ledger by entering in the ledger blank on the pages named in the folio column the accounts shown in the accompanying trial balance. Allow equal space for each account where there is more than one account on a page. On the pages provided make an index of the ledger, entering account titles and page numbers under the proper index letters.

TRIAL BALANCE, DECEMBER 31, 19—

1	Cash.....	\$ 2,348 15		
1	Trade Acceptances Receivable.....			
1	Notes Receivable.....	1,200 —		
2	Amos K. McBride.....	58 20		
2	Craig and Drury.....	285 50		
2	Homer Welbrun.....	176 25		
3	Roy A. Parks.....	148 40		
3	Sundry Customers.....			
3	Merchandise Inventory.....	8,900 —		
4	Accrued Assets.....			
4	Liberty Bonds.....	2,300 —		
4	Furniture and Fixtures.....	1,500 —		
5	Delivery Equipment.....	2,000 —		
5	Buildings.....	15,000 —		
5	Lot #438.....	5,000 —		
6	Trade Acceptances Payable.....			
6	Notes Payable.....		\$ 1,500 —	
6	Chester Pierce.....		1,140 60	
7	Herbert Murray.....		318 20	
7	H. M. Scott and Company.....		1,217 70	
7	Sundry Creditors.....			
8	Accrued Liabilities.....			
8	Mortgage Payable.....		8,000 —	
9	Harold Thatcher, Capital.....		28,000 —	
9	Harold Thatcher, Drawing.....	160 —		
12	Merchandise Purchases.....	45,894 75		
12	Freight Inward.....	392 20		
12	Returned Purchases and Allowances.....		716 25	
13	Merchandise Sales.....		46,718 70	

13	Returned Sales and Allowances.....	593	45		
13	Freight Outward.....	27	50		
14	Salesmen's Salaries.....	250	—		
14	Advertising.....	70	—		
14	General Expense.....	165	90		
15	Office Supplies.....	84	40		
15	Repairs to Building.....	165	—		
15	Office Salaries.....	400	—		
16	Telephone and Telegrams.....	25	50		
16	Insurance.....	28	—		
16	Taxes.....	318	75		
17	Bad Debts.....				
17	Interest Cost.....	285	20		
17	Sales Discount.....	74	15		
18	Interest Income.....			127	75
18	Rent Income.....				
18	Purchase Discount.....			112	10
		\$87,851	30	\$87,851	30

At the top of page 10 open the Profit and Loss account and on page 11 the Merchandise Trading account.

(b) Prepare a test or check trial balance of your ledger by taking off all the debits and then taking off all the credits. The totals must be the same as the trial balance in the text. If you have no adding machine, rule two money columns on a sheet of paper and list all debits (amounts only) in your ledger in the left column and then list all credits (amounts only) in the right column. Total the columns. After this compare each amount in your check trial balance with each amount in the text. They should be in exactly the same order.

Additional information, December 31, 19—:

Merchandise inventory.....	\$14,690 —
Advertising to be charged to next period.....	30 —
General expense not consumed.....	45 —
Office supplies not consumed.....	25 —
Insurance prepaid.....	10 —
Salaries accrued (office).....	50 —
Accrued interest on notes receivable.....	15 —
Accrued interest on mortgage payable.....	120 —
Accrued interest on Liberty bonds....	18.50

The following assets decreased in value through use:

Furniture and fixtures, 1% per month.

Delivery equipment, 1 ½% each month.

Buildings, ½ % per month.

Note that this is a 3-months' period.

(c) Prepare a balance sheet.

(d) Prepare a profit and loss statement.

(e) Write the adjusting and closing journal entries on page 1 of the general journal.

(f) Prepare a post-closing trial balance. On pages 32 and 34 of the journal blank provision is made for recording all trial balances. Write the names of all accounts in the order in which they appear in the ledger, omitting, however, the Profit and Loss and Merchandise Trading accounts as these never have any balance. Be sure to leave vacant one line at the bottom of page 32 and one at the top of page 34 for page totals and totals brought forward respectively. Record the post-closing trial balance in the first two money columns, heading the columns "Post-Closing, Dec. 31, 19—." Some accounts show no balances in this trial balance. These accounts will be used later, therefore they should appear in proper order in all the trial balances recorded on pages 32 and 34 of the journal.

(This problem is continued as Problem 14, Chapter XXV.)

CHAPTER XXV

NEGOTIABLE INSTRUMENTS—PROMISSORY NOTES

Purpose of Chapter.—

1. Contents and form of a promissory note.
2. Indorsements and holders in due course.
3. Settlement of a promissory note.

Negotiable Instruments.—During the unsettled period in Europe about the twelfth and thirteenth centuries, the practice of using a coin-dealer's receipt for moneys on deposit with him rather than the moneys themselves came into general use. The various coins had no standard value, even coins of the same face value differed materially in the value of their precious metal content. This was due to the fact that many rulers, needing more money, put less precious metal in each coin and so made more "pieces" of money. As a result all metal money was thrown under suspicion, the real value not being determinable except by chemical analysis. The money-dealers of Europe made this analysis and issued receipts to the owners for the money turned over. This paper receipt, since it represented the tested value of the money, was more acceptable to merchants than money itself, which required analysis to determine its exact value every time it was exchanged in the purchase of commodities and the settlement of debts.

There was also much less danger attached to the use of these paper receipts than to the interchange of bulky metallic money. Organized bands of robbers often made the movement of metallic money extremely perilous, and so written orders for money, known as "drafts," came into general use.

Thus, temporary local conditions gave rise to the draft and promissory note, two very useful devices of modern business

At present some form of negotiable instrument is used in the transaction of perhaps 90% of the business of the country. Formerly each state had its own negotiable instruments law which differed in some particulars from the laws of the other states. So much of the country's business being interstate business, to attempt to transact it by means of instruments drawn in one state and subject to the laws of another state which might be quite different, was extremely confusing. To avoid this confusion a standard Negotiable Instruments Law has been adopted by all the states of the Union, except Georgia. Such a uniform law has manifest advantages.

What the Negotiable Instrument Is.—The **negotiable instrument** is a formal instrument, almost invariably of paper, which takes the place of money or changes the form of the debt into one more easily converted into money. Two illustrations will be given. Thus, if a man has funds deposited in a bank, he may write an order on the bank in the form of a check to pay out some portion, or all, of those funds to an indicated party. This order is usually accepted as money.

The formal written promise to pay a sum of money at a given time in the form of a note often serves as an intermediate step in the settlement of a debt. Debts are usually settled by payment of money, but at times a formal written promise to pay money, as distinguished from the open account claim, postpones the money payment to a later date. Since this formal promise can be held until maturity, when its value in money will be received, or can be transferred to a creditor to settle a debt and so serve in place of money, or can usually be sold at any time to a banker, the owner of the promise can thus convert it into money. The open account claim cannot easily be converted into money or transferred before its due date. Accordingly, the purpose of the negotiable instrument as an intermediate step in the settlement of debts and its value in the transaction of business are apparent.

Since the negotiable instrument is so important in business, certain requirements as to form and restrictions as to content are laid down in the Negotiable Instruments Law. In order to be negotiable, an instrument must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer.
2. It must contain an unconditional order or promise to pay a certain sum in money.
3. It must be payable on demand or at a fixed or determinable future time.
4. It must be payable to order or to bearer.
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

As compared with the first four this fifth requirement is of minor importance. The meaning and effect of these requirements will be explained.

The most common types of negotiable instruments are:

1. Promissory notes
2. Checks
3. Drafts
4. Trade acceptances, etc.

Post-office and express money-orders, travelers' checks, etc., also are negotiable instruments. This chapter will be devoted to promissory notes.

Essentials of a Promissory Note.—The promissory note is one kind of negotiable instrument. It originates almost invariably in the contracting or settlement of a debt. Money may be borrowed, goods purchased, or services secured on the basis of a formal promise to pay at some future date. An old account or former debt may be due and an extension granted only on the basis of the formal acknowledgment of the debt and the promise to pay it as evidenced by a promissory note.

The promissory note must meet the first four requirements of the negotiable instrument enumerated above. In addition certain non-essential, but almost standard and invariable, requirements are:

1. Date.
2. Place where drawn or where payable.
3. Use of the words "value received."

Form of a Promissory Note.—The information contained in a promissory note may be arranged in any form and may be in pencil or ink. The intention of the party to be bound by his promise is the essential content.

However, as a result of the extensive use of notes, standard forms, easy of recognition, have been adopted. Forms 20(a) and 20(b) illustrate those generally used.

No. 18 Atlanta, Ga. Oct 2, 1921
 Three months after date I promise to pay to
 the order of Ben. F. Wheeler \$325
 Three Hundred Twenty-five Dollars
 at
 Value received
 Due Jan. 2, 1922 Harvey Porter

Form 20. (a) Promissory Note without Interest

\$1000.00 AUG 29 1921 St. Paul, Minn. 19
 Sixty days after date I promise to pay to
 the order of Northwestern Harvester Co.
 One Thousand & no/100 Dollars
 at First National Bank of St. Paul
 Value received with interest at six percent per annum.
 No. 317 Due Oct 28, 1921 Peter Olson

Form 20. (b) Promissory Note with Interest

The student will examine the above notes to see if they meet the essential conditions. Note that certain wording remains practically the same in all. This wording may be printed, whereas the portions which differ, namely, the date, the amount, and the names of the parties, are usually written. It is especially important that the name of the man who makes the promise shall be in his own handwriting, that is, his legal signature. In the forms given there are two parties to the note: the one who makes the promise known as the **maker**, and the other in whose favor it is drawn, that is, the one to whom the promise is made, known as the **payee**.

Definition of a Promissory Note.—In the terms of the Negotiable Instruments Law the **promissory note** is defined as “an unconditional promise in writing made by one person to another, signed by the maker engaging to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.” One or two of these characteristics require explanation.

An “unconditional promise” is an absolute promise not conditioned upon the happening of any event other than the passing of time. An “unconditional promise to pay on demand” means whenever payment is demanded. To pay “at a fixed or determinable future time” means that the date of payment is definitely stated or can be definitely determined from the statement in the instrument. Note that a negotiable promissory note is a promise to pay a definite sum in money. A promise to pay in terms of any other kind of property, for example, wheat, coal, etc., is not a negotiable promissory note, since only money payment will satisfy the requirements. The words “to the order of” make possible the transfer of the instrument from hand to hand, the original payee designating a new payee, who may in turn designate another payee, etc., indefinitely within the time limit of the instrument. The words “or bearer,” when used in a promissory note, make it possible for

anyone possessing, that is, bearing the note, to collect it in accordance with the time limit set and so become the payee of the note.

Advantages of the Promissory Note.—Some of the advantages of the promissory note are:

1. It is presumed that no man will make a formal promise to pay a sum of money unless he owes it. The fact that he does make such a promise is taken as good evidence that he owes the amount promised. In terms of the law this is expressed by the phrase, "a consideration is presumed." In this connection the word "consideration" means anything of value, that is, a man will not make a formal promise to pay unless he has received something of value in return.

2. A promissory note is easily transferred from hand to hand.

3. The amount to be paid is definitely stated and is not subject to proof or controversy.

4. The note bears interest, either from its date of making or its date of maturity.

Through the use of the words "to the order of" and "or bearer" the payee designated in the note may order that it be paid to someone else, who may in turn transfer his right to another party, etc. If the note is payable "to bearer," it may be transferred merely by delivering it; if payable "to the order of," both indorsement and delivery are necessary. The **indorsement**, that is, the signature of the named payee, must usually be made on the reverse side of the note and the note delivered to the new payee.

Forms of Indorsement.—A promissory note may be indorsed in three ways. These are:

1. The unqualified indorsement
2. The qualified indorsement
3. The restrictive indorsement

1. The unqualified indorsement (see Form 21a) may be made in either one of two ways. It may be made in blank by the signing of the payee's name with no other word added. This is called a **blank indorsement** and since it does not name the new payee, its effect is to permit the collection of the note by anyone into whose possession it may fall. It has the same effect as the words "or bearer" on the face of the note.

An unqualified indorsement may also be made by designating the new payee. The customary phraseology of this **full indorsement** is as follows: "Pay to the order of James Grover," followed by the signature of the former payee, in this case George Strong. The effect is to limit payment of the note to the stated payee or to his order, so that he may in turn order payment made to someone else.

2. A qualified indorsement (see Form 21b) usually contains the words "without recourse" and might read: "Pay to the order of James Grover without recourse, George Strong." The effect of this indorsement is to free George Strong from liability for payment of the note in case the original

Form 21. (a) Forms of Unqualified Indorsement

George Strong

Blank Indorsement

*Pay to the order of
James Grover
George Strong*

Indorsement in Full

Form 21. (b) Form of Qualified Indorsement

*Pay to the order of
James Grover
Without recourse
George Strong*

Indorsement without Recourse

Form 21. (c) Forms of Restrictive Indorsement

*Pay to
The Merchants Bank
for collection
George Strong*

Indorsement for Collection

Form 21. (c) Forms of Restrictive
Indorsement (*Continued*)

*Pay to the order of
The Merchants Bank
for deposit only
George Strong*

Indorsement for Deposit

*Pay to
James Scott
only
George Strong*

Indorsement to Transferee only

*Pay to the order of
James Scott
waiving protest
George Strong*

Indorsement Waiving Protest

maker should not pay it when due. Legally any indorser guarantees payment of the note to the new payee in accordance with the terms stated on its face. In the event that the maker does not pay, the indorser may be held liable for payment. It is only because of this guarantee that the note passes readily from hand to hand. The effect of the qualified indorsement is to free the indorser from this liability. He does guarantee, however, that the note is regular in all respects, in that there has been no fraud in its execution, and that the signatures of all parties and indorsers are regular and not fraudulent.

3. The restrictive indorsement (see Form 21c) may restrict the new payee as to his use of the funds collected or may restrict payment to a designated party. The following are types of restrictive indorsements:

(a) "Pay to the Merchants Bank for collection." This allows the Merchants Bank only to collect the note for someone else, the funds collected to be turned over to that party.

(b) "Pay to the order of the Merchants Bank for deposit only." The effect of this is practically the same as that of form (a), the Merchants Bank being appointed a collection agent for the payee of the note, the funds to be deposited to his credit in that bank.

(c) "Pay to James Scott only." This indorsement restricts payment to James Scott and stops the negotiability of the note. Scott, however, may assign the note to another party.

(d) "Waiving protest, pay to the order of James Scott, George Strong," will be explained later, on page 413.

Successive Indorsements.—Standard practice is to write the indorsement across the left end of the note on the reverse side

Pay to the order of
Harry Kelley
John B. Gordon

Pay to the order of
The Leoria Land Co.
Harry Kelley

NOV 19 1921

I promise to pay to
B. Gordon

Dollars

Branch, New York.

Henry C. Watkins
68 Leonard St.

Form 22. Note Showing Indorsements

(see Form 22). There may be any number of indorsements. If there is not sufficient space for all indorsements a strip of paper, called an "allonge," may be attached to the note.

A note may be transferred any time within the time limit, that is, any time before its due date. Transfer may even be made after that date, but such a transfer does not carry with it the guaranty of the indorsers as to payment. If there are five

indorsements on a note, the sixth party being the holder of the note and therefore the one to whom payment is to be made, and if such payment is not made by the maker at maturity, the sixth party must look to the last indorser, that is the fifth party, for payment, because in transferring the note to him this party guaranteed its payment. The fifth party may in turn look to the fourth party for payment for the same reason. Similarly the fourth party may hold the third, the third the second, and the second the first. The first indorser is, of course, the original payee and must rest his claim for payment against the maker of the note who originally promised to pay. The way in which this liability of the successive indorsers is rendered effective will be discussed later under "Dishonored Notes."

The names "indorser" and "indorsee" are sometimes given respectively to the party making the indorsement and to the new payee named in the indorsement. Thus, in the indorsement, "Pay to the order of James Grover, (signed) George Strong," George Strong is the indorser and James Grover the indorsee. If James Grover indorses the note over to Richard Jones, James Grover becomes the indorser and Richard Jones the indorsee.

Who is the Holder in Due Course?—The negotiation of a note raises the question as to who is a bona fide holder, or a "holder in due course," as the law expresses it. A promissory note is a definite contract, which must be lived up to in all respects to make it fully enforceable. The person receiving a note by transfer from another party is expected to examine it to see that it is regular and complete in all respects. The points to be noted are as follows:

1. On the date it is received the note must not be overdue. The man who accepts an overdue note is held to be aware of the fact that the payment date has passed, and that therefore the guaranties of the previous indorsers no longer hold good, since the note was not presented for payment when it became due, or if presented, payment was not secured.

2. The note must indicate by the way in which it is drawn that it is complete and regular and issued in the regular course of business. This means that there are no erasures, no blanks, and that all of the essentials of a negotiable note have been observed.

3. The note must be taken for value and in good faith, that is, there must not be a fraudulent transfer. By "value" is meant any consideration sufficient to support an ordinary contract.

4. The holder when he receives the note must not have notice of any defect or irregularity in the instrument which would invalidate or impair the contract. If he has such knowledge, he is not in the sight of the law the holder in due course. It is ordinarily held that the owner of a note cannot transfer to another any better title than he himself possesses.

5. A man becomes a holder in due course when he secures title by transfer from another who has good title, that is, is himself a holder in due course.

Rights of a Holder in Due Course.—The owner of a promissory note is in a very strong position as a holder in due course, and is entitled at law to collect the amount of the note, when due, from the maker even though there may have been irregularities previous to the time that the present holder acquired the note. Thus, if through force A makes a note in favor of B, as between A and B, B could not collect the note because A could set up the defense that he had been forced against his will to give the note to B. If, however, B transfers the note to C who knows nothing of the way in which B obtained it, C becomes a holder in due course and will be able to collect from A. The law, of course, gives A proper remedy against B. In order, however, for the note to pass from hand to hand and to place it above suspicion, a holder in due course is allowed to hold the maker of the note to the exact terms of the contract. Fraud, want of consideration, failure of title in one of the indorsers, and in most

cases even illegality, are not defenses which the maker can set up against payment of the note. A few defenses, such as forgery, alteration, infancy, and improper execution and delivery, are good even against a holder in due course.

Notes Classified as to Maker.—Notes may be classified from the standpoint of a given business on the basis of the maker of the note. On this basis there are two kinds of notes, namely notes receivable and notes payable.

Notes Receivable. A note made by others payable to the proprietor is a note receivable, as illustrated in Form 23. In this case the payee, James Jackson, the owner of the business, has received a written promise to pay money from a customer, George Strubie.

No. <u>9.</u>	New York, <u>November 3,</u> 192 <u>1</u>
<u>Three months</u>	after date <u>1</u> promise to pay to
the order of <u>James Jackson</u>	<u>\$417.25</u>
<u>Four Hundred Seventeen and 25/100</u>	Dollars
at THE PARK NATIONAL BANK of New York	
Value received <u>with interest</u>	
Due <u>Feb. 3, 1922</u>	<u>George Strubie</u>

Form 23. Note Receivable

The note may be with or without interest. The one illustrated is interest-bearing from the date of the note. Whether interest shall or shall not be charged depends upon the will of the parties. It is held at law, however, that a non-interest-bearing note will bear interest after its due date. In other words, a non-interest-bearing note which is not paid at maturity, will bear interest from that date until paid.

Notes Payable. A note made (signed) by the proprietor in favor of others is a note payable from the maker's point of view.

Thus, the note shown in Form 24, made by James Jackson, the proprietor of the business, is to him a note payable. To George H. Sherman and Company it is a note receivable. The party who makes (signs) a note classifies it as a note payable, while the party in whose favor it is made (payee) classifies it as a note receivable. The one by whom the note is to be paid lists it as a liability while the one to whom it is to be paid lists it as an asset.

No. <u>11.</u>	New York, <u>November 3,</u> 192 <u>1</u>
<u>Three months</u>	after date <u>1</u> promise to pay to
the order of <u>George H. Sherman and Company</u>	<u>\$625⁴⁵/₁₀₀</u>
<u>Six Hundred Twenty-five & 45/100</u>	Dollars
at THE FIFTH AVENUE BANK of New York	
Value received _____	
Due <u>Feb. 3, 1922</u>	<u>James Jackson</u>

Form 24. Note Payable

Notice that this is a non-interest-bearing note. All notes are, of course, either interest-bearing or non-interest-bearing, according to the will of the parties.

Payment of a Note.—When a note falls due it must be presented for payment. Therefore it is necessary to know the business customs and the law of the place where it is payable. The place may be specified on the face of the note as in Form 24, in which case it is payable only at that place. The place may be the maker's office or residence, his bank, or any other place mutually agreed upon. If the maker's bank is named, this constitutes an order on the bank to pay the note when due and charge the amount to the maker's bank account. If no place is specified, presentation at the maker's place of business or at his residence is considered all that is required of the holder of the note.

As to what constitutes "presentation for payment" is sometimes a nice question. The student should be informed as to the law on this point. Where a note is made payable at a given place, it must be presented at that place to the maker of the note or, if he is absent, to any person in charge. If the maker is dead, the presentation should be to the executor or administrator of his estate. The holder must show the instrument and demand payment. If payment is made, the note must be surrendered to the maker. As to time of presentation, the note must be presented on the day stated or determined to be the maturity date of the instrument. A note falling due on Sunday or a legal holiday is payable on the next business day. A note falling due on Saturday, where Saturday is a half-holiday, must be presented by 12 o'clock noon Saturday or on the succeeding Monday.

Presentation must be made at a reasonable hour on the business day. This means that the holder must observe the business custom as to opening and closing hours at the place of payment. It has been held in some cases that presentation may be made at the residence of the maker after business hours.

At this point the student should review Chapter XVI as to the determination of the date of maturity, the amount due, and the proceeds of a discounted note.

Dishonoring Notes.—A note not paid by its maker at maturity is said to be **dishonored**, that is, the maker does not live up to or honor his formal contract. When a note is dishonored, in order to protect the holder's rights, it is customary to make what is called a normal **protest**. The student will recall that when a note is negotiated, each holder accepts the note on the basis of the guaranty of its collectibility by the previous holder. The holder of the note in whose possession it is dishonored will, therefore, look to the party from whom he received it for payment. That party may in turn look to the party from whom he received it, etc. In order, however, to compel payment by a previous

holder, notice must be given to him by the present holder, his agent, or by a notary. The law requires that this notice be given on the day following the day of dishonor. If the party to whom notice is to be sent has placed his address on the instrument, notice must be sent to that address; otherwise to his place of business or his residence. If, in transferring title to the note, any indorser has signed it, using the words, "waiving notice of protest," such indorser can be held without giving him formal notice of protest within the customary day limit set for such notice. Unless, however, such notice is given to all other indorsers within the day limit, they are released from their guaranty and no action can be instituted against them for the collection of the note. The holder must, in this case, collect the note from the maker by process of law. The procedure of formal protest is somewhat as follows:

The holder of a dishonored note goes before a notary and makes a sworn statement of all the facts in the case, chief of which are that he holds a note now due and payable by its maker, that presentation for payment has been made, that payment has been refused, or that presentation was impossible because of inability to find the maker at his customary place of business or residence. The notary enters these facts in his notarial record, takes the note, and himself attempts presentation for payment. If payment is still refused, the notary sends formal notices to that effect to all the previous holders whom it is desired to hold to their contracts of guaranty, if their addresses are known. If not known, the notices are sent to the next previous holder who takes his and in turn sends them on to the holder from whom he received the note, etc., until, in due course, all notices of dishonor have been delivered to the proper parties. In this way each holder may collect from the next previous holder until the original payee is reached, who must look to the maker of the note for satisfaction. In Forms 25 and 26 are given illustrations of the protested note, the certificate of protest, and the notice of dishonor. These are self-explanatory.

\$500⁰⁰

New York, Jan 7, 1921

Six months after date I promise to pay to
 the order of Frank L. Parsons
Five Hundred & ^{no}/₁₀₀ Dollars
at 44 Wall St., New York City

Value received

No 86 Dec 7, 1921 George T. Monroe

United States of America,

State of New York,

City of New York.

On the seventh day of July, 1921.

at the request of Charles S. Richardson
 I, Ralph Stevens, a Notary Public of the State of New York,
 duly commissioned and sworn, dwelling in New York City, did
 present the original promissory note hereunto annexed,
 to George T. Monroe

at the maker's office, 44 Wall Street, New York City

and demanded payment thereof, which was refused because of inability
 to locate maker.

Whereupon I, the said Notary, at the request aforesaid, did Protest, and these presents
 do publicly and solemnly Protest, as well against the Drawer and Endorser of the said
promissory note as against all others whom it doth or may concern, for exchange,
 re-exchange and all cost, damages and interest already incurred, and to be hereafter incurred for want of
payment of the same.

Thus Done and Protested in the City of New York, aforesaid, in the presence of
 John Doe and Richard Roe, witnesses.

IN TESTIMONIUM VERITATIS

Ralph Stevens
 Notary Public.

United States of America,

State of New York,

City of New York,

ss.

I, Ralph Stevens, a Notary Public of
 the State of New York, duly commissioned and sworn, do hereby Certify
 that on the seventh day of July, one thousand

nine hundred and twenty-one notice of the presentment and protest of the said promissory note
 after demand and refusal of payment thereof, by notice, partly written and partly printed, signed by me, was
 given by me to the maker and respective endorser of the said instrument, by depositing the same
 in the Post Office at the City of New York (prepaying the postage thereon), duly
 directed and superscribed to said maker and
 endorser, as follows, to wit: To George T. Monroe, 44 Wall Street, New York City

Frank L. Parsons, 293 Lawrence Street, Yonkers, N. Y.

to above named place being the reputed place of residence of the person to whom such notice was
 so addressed, and the Post Office nearest thereto.

In Testimony Whereof, I have hereunto set my hand and affixed my
 official seal at the City of New York

Ralph Stevens
 Notary Public.

.....
 NOTARY'S
 SEAL

New York, July 7, 1921**Please to take Notice,** That a Promissory Note made byGeorge T. Monroe,for Five hundred and no/100 Dollarsdated January 7, 1921payable at at the maker's office, 44 Wall Street, New York City

endorsed by you, having been this day presented for payment which was duly demanded and refused, is **protested** for non-payment, and that the holder look to you for the payment thereof.

Your obedient servant,

Ralph Stevens

Notary Public.

To **Frank L. Parsons**
293 Lawrence Street
Yonkers, New York

Form 26. Notice of Dishonor

Recording a Dishonored Note.—The entries to record on the books of the payee, Frank L. Parsons, the payment to Richardson for the dishonored note transaction above are as follows:

CASH BOOK (DISBURSEMENTS)

1921				
July 9	George T. Monroe	Charles S. Richardson check for George T. Monroe's 6-mo. note dishonored and protested 7/7/21	502	50
		Face	500	—
		Protest fees	2.50	

It will be noted that the customer (maker) is charged, in his open account, with the amount of the note and protest fees. The protest fees should be charged to the maker, and not to an expense account, because the maker's failure to pay his note has made him legally liable for the fees also. Although the holder

(Charles S. Richardson) returns the dishonored note to the payee after protest, the payee records his payment of the note and protest fees, not in the Note Receivable account, which is reserved only for unmatured notes, but in the maker's open account which thus shows a full history of all dealings with him and will serve as a guide in future dealings. Although the protested note is still a note receivable, the entry to record collection from the maker will be a debit to Cash and a credit to George T. Monroe's open account.

QUESTIONS

1. What was the origin of paper money?
2. What do you understand by the standard Negotiable Instruments Law?
3. Explain what you understand by a negotiable instrument. Give some examples.
4. Give some uses and advantages of negotiable instruments.
5. What does the word, "negotiable," mean?
6. Name and explain the requirements necessary to make an instrument negotiable.
7. Name several uses of the promissory note. What are its essentials? What the non-essentials? Explain these fully.
8. Explain the two terms "maker" and "payee" as used in connection with a note.
9. How is a promissory note negotiated or transferred?
10. Explain fully the three kinds or forms of indorsements, showing how each is written.
11. What is the legal effect of an indorsement?
12. How many indorsements may a note have?
13. Who is an indorsee?
14. What is meant by a holder in due course?
15. Distinguish between a note receivable and a note payable.
16. Where is a note payable?
17. What is meant by presentation for payment? How is presentation legally made?
18. How do you find: (a) the date of maturity of a note; (b) the amount due; (c) the proceeds of a discounted note?
19. When is a note said to be dishonored? State the necessary procedure of formal protest.

20. What entries are made when a note receivable is dishonored and protested?

21. Should the Note Receivable account contain any past-due notes? Explain.

22. What is the purpose of transferring past-due notes to the customer's account? Of what use is the information in the customer's account?

PROBLEMS

1. On February 26, 19—, Thomas Southmayd of Duluth, Minn., gives you a 90-day, 6% interest-bearing note, dated February 25, 19—, in settlement of his account, amounting to \$353.42. The note is payable at the Empire Commercial Bank of Duluth, Minn.

(a) Write the note.

(b) Give the entry to be made by the maker at the time he issues the note.

(c) Give the entry to be made by the payee at the time he receives the note.

(d) Give the maker's entry when he pays the note.

(e) Give the payee's entry when he receives payment for the note.

2. On November 20, 19—, you give your 90-day, 6% interest-bearing note to the National Garment Company of Rochester, N. Y., in settlement of your account, which amounts to \$463.75. Note is payable at your address.

(a) Write the note.

(b) Give your entry at the time you issue the note.

(c) At the time you pay the note.

(d) Give the entry to be made by the payee at the time the note is received.

(e) At the time the note is paid.

3. On October 25, 19—, P. R. Griffin, Holyoke, Mass., discounts his 6%, 90-day note, amounting to \$500, with the Holyoke National Bank.

(a) Write the note.

(b) Give the entry to be made by the maker when the note is discounted.

(c) At the time the note is paid.

4. On June 10, 19—, the National Grocery Company of Pittsburgh, Pa., receives a 90-day, non-interest-bearing note for \$355.25 from C. E. Thomas, Erie, Pa., in settlement of his account, which amounts to \$350. The note is payable at Erie, Pa., and includes 6% interest.

- (a) Write the note.
- (b) Give the entry to be made by the maker at the time the note is issued.
- (c) Give the entry to be made by the payee at the time the note is received.

5. On September 9, 19—, the National Grocery Company, Pittsburgh, Pa., receives a formal notice of protest, stating that C. E. Thomas, Erie, Pa., refused to pay his 90-day note for \$355.25 on which the fees are \$1.50. Write the entry to be made by the company at the time they pay the protested note.

6. On July 10, 19—, G. W. Peck, Elmira, N. Y., transfers to you by full indorsement a 3-months, 6% interest-bearing note for \$250 which he had received from a customer, L. B. Laughlin of Hudson, N. Y. The note is dated June 10, 19—, and is payable at the Hudson Commercial Bank, Hudson, N. Y. Mr. Peck requests you to apply the note with the accrued interest to his account.

- (a) Write the note and the indorsement.
- (b) Give the entry to be made by the maker, L. B. Laughlin, at the time the note is issued.
- (c) At the time the note is paid.
- (d) Give the entry you would make at the time the note is received.
- (e) At the time the note is paid.
- (f) Give the entry the payee would make at the time the note is transferred.

7. You are auditing the books of A. O. Scott, Fitchburg, Mass., and you find that he possesses a 3-months, 6% interest-bearing note for \$250, dated October 31, 19—, made by Clinton Moore of Haverhill, Mass., payable to the holder at Haverhill.

- (a) Write the note.
- (b) Give the entry to adjust the interest account at the time of closing the books, December 31, 19—.

8. On June 1, 19—, Frank H. Ross of Lynn, Mass., purchases from C. H. Humphreys, Lawrence, Mass., a 3-months, 6% interest-bearing note for \$650, dated April 1, 19—, made by George W. Smith of Lowell, Mass., and payable at Lowell. The note is transferred to Mr. Ross by a blank indorsement. The purchase price includes the interest accrued to June 1.

- (a) Write the note and its indorsement.
- (b) Give the entry to be made by the payee, Mr. Humphreys, at the time the note is transferred.

(c) Give the entry to be made by the purchaser at the time the note is purchased.

9. On July 1, 19—, F. H. Ross is notified that George W. Smith has dishonored the note of April 1, 19—, amounting to \$650.

(a) Write the entry to be made by Ross.

(b) Write a brief letter to Mr. Ross, stating the procedure necessary to hold C. H. Humphreys liable.

10. On June 25, 19—, Robert J. Hicks of Lancaster, Pa., gives his 60-day, non-interest-bearing note for \$1,200 to the Adams Merchandising Company, of New York City, for purchases made on account from the latter firm.

(a) Write the note.

(b) Give the entry to be made by the maker at the time he issues the note.

(c) Give the entry to be made by the payee at the time the note is received.

11. The Adams Merchandising Company, wishes to transfer the above note to R. H. Glenn without being held liable for payment. The note is transferred on May 25, 19—, in payment of a debt owed by the company.

(a) Write the proper indorsement.

(b) Give the entry to be made by the transferror at the time the note is transferred.

(c) Would the transferror make an entry at the time the note is paid? Why?

(d) Give the entry to be made by the transferee at the time the note is received.

(e) At the time the note is paid.

(f) Give the entry to be made by the maker at the time the note is paid.

12. W. P. Johnson of Galveston, Texas, is the holder of a 90-day, 6% interest-bearing note, amounting to \$525, dated April 15, 19—, made by J. W. Hartman of Houston, Texas, a customer of his, the note being payable at Houston. The note is presented for payment on its due date, but payment is refused.

(a) Write the note.

(b) Give the entry to be made by the payee at the time the note is dishonored.

13. The Heyden Chemical Company of New York City is the holder of a 60-day, non-interest-bearing note, dated October 15, 19—, made by

the Meyers Drug Company of Albany, N. Y., for \$250, payable at the latter's place of business. On its due date the maker is not able to pay the note, but sends a check for \$100, drawn on the Albany Trust Company and a 60-day, 6% interest-bearing note for \$150, to cover payment of maturing note.

- (a) Write the first note.
- (b) Write the second note.
- (c) Give the entry to be made by the Heyden Chemical Company, at the time the check and the \$150 note are received.
- (d) Give the entry to be made by the maker at the time the second note is issued.

14. A series of transactions to be recorded in the bound blank books provided—a continuation of Problem 14, Chapter XXIV.

This is a continuation of Mr. Thatcher's business for the month of January, 19—. As bookkeeper, you will record the following transactions in sales journal, page 29, purchase journal, page 31, cash book, page 18, in addition to the general journal and ledger you used in Chapter XXIV.

January, 19—.

2. Sold \$750 of merchandise to Homer Welbrun, St. Joseph, Mo., terms 20-day note with interest. Bought merchandise from H. M. Scott and Company, Denver, Colo., \$2,200, on our 60-day note with interest at 6%.
3. Received check from Roy A. Parks, Columbus, Ohio, in full of his account, less 2%. Paid office clerks' salaries in cash \$125. This includes the \$50 of salaries accrued to December 31. Sent Allen and Company our check for \$120 in full payment for interest accrued on mortgage to December 31.
5. Discounted at the First National Bank our 60-day note for \$2,000, receiving credit for the proceeds. Sent Allen and Company our check for \$2,000 to apply on the principal of the mortgage we owe them.
6. Cash sales of merchandise for the week, \$13,460.20. Enter this in the sales journal and then in the cash book. Purchased merchandise for cash from sundry dealers \$9,746.85.
8. Gave Herbert Murray check for \$308.65 in full payment of account, \$318.20, less 3% discount.
9. Sold to Amos K. McBride, Pittsburgh, Pa., one-half on 30-day note, one-half on account, 2/10, n/30, merchandise of \$1,264. Mr. Thatcher withdrew cash for personal use \$50.

10. Paid Chester Pierce, St. Paul, Minn., in full settlement of account by giving him our 30-day note with interest for \$900, and cash for the balance due him, less 2%.
 12. Received check for \$866.70 from Arthur Hadley, Atlanta, Ga., in payment of his note for \$850 due today and \$16.70 interest. This includes \$15 accrued interest.
 14. Purchased from Herbert Murray, Nashville, Tenn., merchandise \$3,000, terms cash \$500, 60-day note with interest \$1,500, on account, 2/10, n/30, \$1,000.
 16. Bought for cash from the Dunham Desk Company new office desk \$125.
 17. Paid office clerks' and bookkeepers' salaries in cash \$200. This includes \$50 for your services as bookkeeper.
 20. Returned to Herbert Murray merchandise billed to us at \$150 because it was not the kind ordered, and asked them to send credit memorandum.
 22. Homer Welbrun sent his check for \$752.50 in payment of his 20-day interest-bearing note of the 2d instant.
 23. John Drury allowed us 6% discount for prepaying our 4-months, non-interest-bearing note of November 9, 19—. Face of note \$1,200.
 24. We received notice of protest for non-payment from the First National Bank, stating that Craig and Drury, Trenton, N. J., failed to honor their note for \$200 and that they demanded payment for the note and \$3 in protest fees from us, as we were indorsers. This is one of a number of notes we discounted last year. We gave the bank our check to cover note and protest fees.
 27. Paid cash for office supplies \$38.60; advertising \$58.75. Purchased merchandise for cash from sundry dealers \$2,684.90.
 30. Sold merchandise for cash to sundry customers \$6,976.73.
 31. Paid—————R. R. by check for freight on merchandise \$216.75. Of this amount \$183.90 applies to purchases and the balance to sales. Paid telephone and telegraph bills in cash \$12.40. Paid salesmen's salaries in cash \$225.
- (a) Record the above transactions in the various books of original entry.
- (b) Write the summaries and rule off each book.
- (c) Post and take a trial balance and record it on pages 32 and 34 of the journal blank. Enter the amounts in the third and fourth money columns

opposite the proper account titles. *Do not rewrite account titles.* Head the third and fourth columns, "Jan. 31, 19—."

Note: In handling the group transaction of cash sales and purchases post the sundry sales and purchases to the following accounts; Sundry Customers, and Sundry Creditors.

(This problem is continued in Problem 15, Chapter XXVI.)

CHAPTER XXVI

BANKS AND THEIR FUNCTIONS

Purpose of Chapter.—

1. Nature and function of banks.
2. Deposits and checks.
3. Reconciliation of bank balance.
4. Various check operations.

What the Bank Is.—A bank is a business institution for the safe-keeping, loan, exchange, or issue of money. It is sometimes spoken of as an institution for credit. What is meant by this we shall attempt to explain. A banker organizes his business by the investment of a cash capital in much the same way that every other business man does. The most obvious function of a bank is the safe-keeping of funds. The banker has in his possession a great deal more money than he himself put into his business. Experience shows that seldom, if ever, are all of the moneys which have been placed with a banker for safe-keeping called for by depositors at one time. Hence, the banker knows that he will have available large sums in addition to his own investment for the payment of checks drawn on the bank.

The amount of funds which the banker must keep on hand to meet checks drawn against his bank is larger in some countries than in others. The natural characteristics of the people, and their conservatism in doing business and in placing trust in their bank are all factors which the banker must take into account. Naturally he cannot be expected to safeguard the funds of his depositors without recompense. This recompense, from the beginning of banking, has usually taken the form of allowing the banker to lend the unused funds of his depositors. A banker

lending money does not usually hand the money over to the borrower but gives him the right to draw checks on the bank up to the amount of the loan. Money will be paid out only as these checks are presented to the bank for payment. Thus, the right of drawing on the bank is called an "extension of credit" to the borrower.

How much credit can be extended by the bank to its borrowers will depend on the amount of money in the bank, this money belonging both to the bank's depositors and to the bank itself. The bank must, of course, never allow itself to get into the position where it will not have sufficient money to pay all checks presented to it for payment. However, inasmuch as banking experience shows that all depositors never want all of their funds at the same time, there is always lying in the bank, moneys which can be used to pay the checks of the parties to whom the bank has extended credit. In this way a bank with actual money on hand of \$100,000 might make loans to borrowers totaling \$200,000 or \$300,000. Granting a depositor the right to check against the bank for amounts over and above the actual amount of money that the depositor may have in the bank is called the "lending of credit." It is on credit that the country does most of its business. Without this system, many times the present amount of money would be needed.

How the Bank Is Paid for its Services.—It was stated above that the bank does not usually make any charge for acting as a guardian of the funds of depositors. It does, however, reserve the right to use these funds as a basis for extending credit, that is, for making loans to business men and others, for which it makes a charge under the head of "interest" or "discount." This is the chief source of income of the bank and is an indirect charge against the depositor for safeguarding his funds. The student will appreciate the value of this right when he considers that on the basis of \$100,000 of cash deposited with the bank, the banker may make loans of \$200,000 or \$300,000 on which he

will receive interest. The banker usually makes a charge also for the collection of checks, notes, drafts, etc., the purchase of stocks and bonds, and other incidental services.

Kinds of Banks.—There are two principal kinds of banks: (1) commercial banks, or banks of discount, and (2) savings banks.

Under commercial banks we have:

(a) National banks, chartered by and deriving their authority from the federal government. Such banks are controlled by and are subject to examination by the federal government.

(b) State banks, which get their authority from the state in which they are located.

(c) Trust companies, chartered by the state, and originally organized to do a trust business, but nearly always doing a certain amount of commercial banking.

(d) A super bank, a bank's bank, known as the "federal reserve banking system." The country is divided geographically into 12 districts in each of which there is a reserve bank. These banks transact business only with the banks in their district that are members of the reserve banking system. National banks, state banks, and trust companies are, or may become, members of the federal reserve banking system.

Savings banks are of several kinds:

(a) The United States postal savings bank, for which each postmaster is the representative. He will receive moneys for deposit in the postal savings bank.

(b) Mutual savings banks, which are operated for the mutual benefit of all depositors and in a sense are owned by them. They are conducted, however, by a self-appointed board of trustees, which does not own the bank and is not financially liable for its debts.

(c) Stock savings banks, which are stock corporations duly formed and owned by their stockholders. Such a bank upon accepting a savings deposit, contracts with the depositor to pay

a fixed rate of interest on sums left on deposit, in accordance with definite regulations. All income beyond the amounts due depositors belongs to the owners of the bank. In the mutual savings bank all income earned above a certain amount reserved for safety must be distributed pro rata among the depositors.

(d) State savings banks, which are similar to the United States postal savings bank, in that they are owned and operated by the state.

(e) Savings departments of commercial banks, which pay a fixed rate of interest to depositors but are in no sense mutual savings banks.

Functions of Commercial Banks.—The commercial bank performs the following services for the business community:

1. It provides a safe and convenient place for the deposit of money.

2. It enables the depositor to withdraw money by means of a written order known as a **check**.

3. The check may be used not only for personally withdrawing money but also for transferring money to someone else. The bank holding on deposit the funds of a business man will at his order pay or transfer the money to the party he names. In this way the risk and inconvenience of handling money is reduced, because the check will not be cashed by the bank without proper indorsement. The check when paid is canceled, that is, marked "Paid," and returned to the depositor issuing it, serving as good evidence that the sum has been paid.

4. One of the chief functions is lending money. This is done usually on the basis of a promissory note drawn in favor of the bank by the borrower. To protect itself the bank may demand that another party indorse the note, guaranteeing its payment in case the borrower fails to pay it. This is known as "double" or "two-name" paper in that there are two parties to whom the bank may look for payment. Such a note from the banker's

standpoint is a better note as to security than one signed only by the borrower and known as "one-name" paper. Instead of an additional indorser, the banker may require the deposit of collateral security, such as certificates of stock or bonds that have a ready marketable value. These are turned over to the banker under a contract which gives him the right to sell them and apply as much of the proceeds as are necessary to the payment of the note if it is not paid by the borrower when due. A commercial bank may not usually lend money on real estate.

5. A bank may discount or buy negotiable instruments, such as promissory notes, drafts, bills of exchange, trade acceptances, etc.

6. All banks undertake for their customers the collection of negotiable instruments, or commercial paper, including promissory notes, drafts, interest coupons on bonds, dividend checks, other checks, and the like. A charge is often made for these services.

7. The bank provides a convenient way to pay debts at a distance without the actual transfer of the debtor's funds, by issuing its own checks, known as "bank drafts" or "cashier's checks," by lending credit, and by certifying its depositor's checks.

8. The commercial bank will accept funds on deposit not subject to check for which it issues certificates of deposit. Generally, though not always, this certificate will bear interest. Interest is not usually allowed on a small checking account. Hence, to receive interest, a small depositor must ordinarily deposit his funds under the certificate of deposit plan and give up the privilege of checking against this special deposit.

9. National banks and federal reserve banks have the right to issue paper money. This money is in the nature of a promissory note given by the bank, payable on demand. These notes are known as "national bank" notes and "federal reserve bank" notes.

10. All trust companies, national banks to a large extent, and state banks in some cases, exercise trust powers, i.e., act as

trustees in decedents' estates, in bankruptcies, and as executors of wills, guardians of minors, registrars of stocks and bonds, and in practically all other cases where an individual might act as a trustee.

Functions of Savings Banks.—The handling of money by savings banks is limited by law to the following functions:

1. It may receive funds on deposit and pay to depositors a small rate of interest or such rate as it may earn, thus encouraging savings in small amounts, since an account of almost any size is subject to interest. By combining many small amounts from a great number of people, large funds are provided. Money which would otherwise be tied up in presumably safe places and so kept out of circulation is thus thrown into the regular channels of trade.

2. The savings bank may permit the depositor to withdraw his funds on demand, or it may require a few days' notice of intention to withdraw.

3. The lending of money by the savings bank is restricted by law to definite conditions. It may lend money on mortgage loans or real estate security; it may invest in the bonds of municipalities, public service companies, and manufacturing enterprises to a limited extent. Inasmuch as there is not a uniform savings bank law, each state's laws must be examined before the exact requirements as to loans and investments of a savings bank can be determined. Usually, however, investment is limited to government, state, city, county, and school district bonds, bonds of railroads, street railway companies, light and power companies. In some cases investment in the bonds of high-grade manufacturing enterprises and in the stock of banks is permitted.

Opening an Account with a Commercial Bank.—In dealing with a commercial bank the first step is for the prospective depositor to introduce himself to the manager of the bank or to be

introduced by one of the bank's depositors. If the introduction is satisfactory and the banker desires the party to become a depositor, the arrangement is made to accept whatever moneys the depositor places with the bank, subject to withdrawal on his order or check. Most banks require a minimum amount to be kept on deposit at all times. The expense incurred by the bank in safe-keeping its depositors' funds, in handling their checks, and in rendering miscellaneous services is not inconsiderable. To recompense itself the bank must be assured that a certain amount will be kept constantly on deposit to serve as a basis for loans and discounts. Before the bank will allow a depositor to draw checks, it must have one or several of the signatures which the depositor intends to use on his checks. Since the bank agrees not to pay out any money except on the order of the depositor, it must pass on the genuineness of the signature of every check drawn by him. This copy of the depositor's authorized signature is made on the signature card. These cards are then placed in files for ready reference by the employees of the bank whenever checks are presented for payment. Having supplied his official signature, the depositor receives from the bank a pass-book and two kinds of blanks: One, known as the deposit ticket, is used whenever he deposits money; the other, known as the check, is used for the withdrawal of money.

The Deposit Ticket.—The deposit ticket (Form 27) is used for the purpose of listing the various kinds of money deposited at a given time. Provision is made for listing gold, silver, bills, and checks. The gold and silver coins should be kept separate. The bills should be arranged in packages according to their denomination, \$1 bills in one package, \$5 bills in another, etc., and in the same order, that is, face up, and all lying one way. Checks are to be listed separately. Make sure that they are properly indorsed.

In preparing the deposit ticket omit all \$ signs and be careful to place the figures underneath one another so as to make addi-

Deposited to the Account of			
<i>Henry Martin</i>			
in the Fifth Avenue Office			
Guaranty Trust Company of New York			
New York <i>Aug. 12 1921</i>			
Please enter each check separately			
	Dollars		Cents
Coin	<i>322</i>		<i>45</i>
Bills	<i>811</i>		<i>—</i>
Checks <i>1-25</i>	<i>162</i>		<i>90</i>
<i>53-19</i>	<i>85</i>		<i>78</i>
<i>50-494</i>	<i>46</i>		<i>25</i>
<i>Ex. m/o. Bflo. N.Y.</i>	<i>12</i>		<i>33</i>
	<i>1440</i>		<i>71</i>
Safe Deposit Vaults			

Form 27. Deposit Ticket

tion easy. The deposit ticket is an important document, as it constitutes the original entry of the deposit. Many business men take the precaution to keep a carbon copy of every ticket.

The banker accepts any of the legal moneys of the country, such as gold, silver, nickel, copper, and the various kinds of paper money. He accepts also checks on other banks or on his own bank, on the condition that they can be collected.

In case a deposit-

ed check proves uncollectible, its amount is charged back against the depositor's account and the check returned to him.

The Bank Pass-Book.—Having made out his deposit ticket and arranged his deposit in the same order in which it appears on the ticket, the depositor takes both to the receiving teller who verifies the deposit item by item, and also the total amount. If

found correct, the amount is entered in the depositor's bank pass-book which should be presented by him at the time each deposit is made. In the absence of the pass-book a duplicate deposit ticket may be presented for the receiving teller's signature. The pass-book is a small bound memorandum book with a date column at the left, a wider explanation column, and a single money column. Entries in the deposit book are always made by the bank teller, never by the depositor. This pass-book is a memorandum receipt for moneys turned over to the bank and may also be used for the periodic statement of the condition of the depositor's account.

The Bank Check.—The depositor is now in a position to draw checks against this deposit for the settlement of debts or for other purposes. In the sight of the law the check is a negotiable instrument. Its fundamental legal characteristics are those of a negotiable instrument, being a written order on a bank, demanding payment of a definite sum of money, the order being signed by the maker of the check. By reference to Forms 28(a), (b), and (c) the essential and the non-essential parts of the check may be noted. The essential items are:

1. The date.
2. The name of the bank on which drawn.
3. The definite order or demand evidenced by the phrases:
 - (a) "Pay to the order of."
 - (b) "Pay to Bearer."
4. The statement in both words and figures of the sum of money involved.
5. The signature of the maker of the check, that is, the depositor.

The non-essential items are: (1) the check number, and (2) the purpose for which the check is given. Although not essential, these are very convenient, especially the check number which facilitates the proof of the correctness of the depositor's bank balance, as explained later.

The parties to a check are:

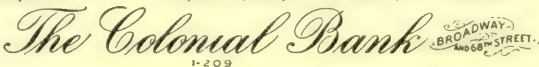
1. The drawer, or maker.
2. The payee, to whom the check is made payable.
3. The drawee, i.e., the bank on which it is drawn.

A check is often made payable to "Cash," "Myself," "Bearer," "New York Draft," "Pay-Roll," etc. This indicates that the check is payable to a bearer personally known to the paying teller. A check made payable to "New York Draft," "Pay-Roll," etc., indicates the purpose for which it is drawn.

The check as compared with the promissory note has these points of similarity and difference:

1. They are the same in that they are both negotiable instruments.
2. They are the same in that each is transferred by indorsement.
3. They differ in that the note is a *promise* to pay, however, while the check is an *order* or request to pay.
4. They differ in that the check is a demand order and is therefore looked upon as cash, while the promissory note is usually payable at a future time rather than on demand.

Form of Check.—Three standard forms of check are shown in Forms 28(a), (b), and (c). Their chief difference is in the ar-

No. <u>1364</u>	New York, Nov 16 1921
	
Pay to the order of <u>Cash</u>	\$ <u>1984³⁵/₁₀₀</u>
<u>Nineteen Hundred Eighty-four & 35/100</u> Dollars PAYABLE THROUGH NEW YORK CLEARING HOUSE	
Safe Deposit Vault,	Richard Carson

Form 28. (a) Check Payable to "Cash"

angement of the material on the face of the check. In drawing checks it is always best first to make the memorandum contain-

ing the essential information on the stub or interleaf. The next steps are to date the check; write the name of the payee; and then write the amount beginning well to the left. Use plenty of ink.

No. <u>897</u>	NEW YORK, <u>October 16 1921</u>
ALLIANCE SHIPPING COMPANY, INC.	
PAY TO THE ORDER OF <u>Henderson & Williams</u>	
<u>Three hundred ninety-seven & 50/100</u> — \$ <u>397.50</u>	
TO GUARANTY TRUST COMPANY OF NEW YORK	ALLIANCE SHIPPING COMPANY, INC. <u>Geo M. Bartlett</u> TREASURER

Form 28. (b) Draft Form of Check

Leave no spaces between words. Fill all blank spaces with a wavy line. Write figures close up to the \$ sign, and make sure that they are legible. Usually a simple plain signature is harder to forge than an illegible one with many flourishes and contortions.

No. <u>376</u>	New York <u>Dec. 16 1921</u>
Irving National Bank W Woolworth Building	
Pay to the order of <u>Arthur M. Ramsey</u>	
<u>Eighty-two cents only</u> — ~~Dollars~~	
<u>\$ $\frac{82}{100}$</u>	<u>Henry Morrison</u>

THROUGH NEW YORK CLEARING HOUSE

WESTBROOK PRITS & SUPPLY CO., N.Y.

Form 28. (c) Check for Less than One Dollar

When writing a check for less than \$1 (see Form 28c), in filling in the written amount, follow it with the words "Cents Only," for example, "Sixty-nine Cents Only," and cross out the printed word "Dollars." After the amount in figures one may also write the word "Only," for example, " $\frac{69}{100}$ only." This aids the paying teller when the check is presented for payment.

Check Indorsements.—For purposes of transfer and before presentation to the bank for payment, checks must be properly indorsed. The various forms of indorsement explained in Chapter XXV on promissory notes are also used for checks. The full indorsement is preferable in all cases. This is shown in Form 21(a). Checks made payable to "Cash," when presented by the maker, do not ordinarily have to be indorsed; those made payable to "Myself," "Bearer," or "Pay-Roll," if the cash is to be passed over the counter to the maker of the check or to another party, must usually be indorsed by the receiving party. A check made payable to a special pay-roll account in the bank, to be disbursed by it, and checks made payable to "New York Draft," etc.—in other words, checks so drawn that the bank itself is to get the funds and is not to pass them over the counter to the one presenting the check—do not ordinarily require indorsement.

The protection of checks from alteration is a serious problem in these days when expert crooks by the use of bleaching acid and other tools and devices of the art of alterations have made the detection of erasures and alterations almost impossible. Various devices are used to protect against fraud, as where the amount of the check is cut into or perforated through the paper and the cut edges inked with indelible ink; the use of printed marginal maximum amounts so that the check will not be good for more than the indicated maximum; the use of special water-marked paper; the use of forge-proof ink. These have all been helpful, but are not wholly successful. The bank is liable if it makes payment on a check with a forged signature. In the case of alteration of other portions of the check, as for example, raising the amount, the maker suffers the loss. Writing the check in accordance with the directions given above prevents many of the simpler and more apparent alterations. However, even the best protected checks are often changed by a clever crook, in such a way as to escape detection by the watchful eye of the bank clerk.

Recording Dealings with the Bank.—A record must be kept of dealings with the bank, just as with each customer and creditor. The bank is charged with moneys deposited and credited with checks drawn. The manner of recording these charges and credits varies. In most cases, however, the check book is used for this purpose. There are many forms of check books, one type being shown in Form 31.

Check books are printed with either several checks or only one check to the page. Where a stub is not provided, an interleaf between checks is used to record the essential memoranda concerning the check. Form 31 shows a check book with stubs having one side for memoranda of checks drawn and the other for memoranda of deposits made. After the memorandum has been made out on the stub or interleaf, the check itself is written. The number on the stub or interleaf agrees with the number on the check. Filling out the stub or interleaf first prevents many errors that might be made were the check written first, and also prevents the spoiling of checks. Although the depositor has a pass-book with a record of deposits made, this shows only the total of each deposit. It is customary to keep a detailed record of deposits in the check book also, using the reverse side of the stub or interleaf. For each check deposited, the maker, the date the check was received, its transit number,¹ and the amount should be entered. The total of the deposits is carried forward from reverse page to reverse page, just as the amount of checks drawn on the face of the stub or interleaf is carried forward. The amount available for checking can be found by subtracting total checks from total deposits. This method of keeping the bank account, barring errors made in recording, should always prevent overdrafts, that is, the issuing of checks for an amount greater than funds available in the bank.

¹ The transit number of a check indicates the bank on which the check was drawn. Every bank in the country is given a transit number by which its checks as they pass from hand to hand may be kept track of, thus saving the necessity of writing its name in full. For this purpose the country is districted, and each bank given its district number as well as its own number within that district. Thus, the number 1-45 applies to the Corn Exchange Bank of New York, (1) representing the district number and (45) the bank's number within that district. Where a transit number is not given, the name of the bank should be recorded

Balancing the Bank Account.—To confirm his record of his bank account, the depositor should have a periodic statement from the bank showing its record of his account. In the bank's record the depositor is credited with all sums deposited and charged with all checks paid. When the bank pays a check for the depositor, it is marked "Canceled" or "Paid," the date of payment being shown. Thus, canceled checks show what items have been paid for the depositor's account. When the bank renders its statement, the canceled checks are returned as evidence for the charges which the bank has made against the account.

Two methods are used by the bank in rendering the periodic statement. In the first case the depositor's pass-book showing his deposits composes the credit side of his account. These credit entries are totaled and from the total is subtracted on the face of the pass-book page the total of the canceled checks returned. An adding machine list of the checks is often included wrapped around the bunch of checks. The difference between the total of the deposits and the total of the checks is shown as the new balance. A balanced pass-book is shown in Form 29.

2/1	<i>J K</i>	\$ 375.20
2/5	<i>J B</i>	759.35
2/17	<i>J B</i>	126.75
2/25	<i>J B</i>	237.80
2/28/21	Total Credits	\$ 1,499.10
Less	Vouchers Ret'd per list	867.90
2/28/21	Balance	\$ 631.20

Form 29. Pass-Book Balanced

memorandum receipt for the deposits made, it never being totaled or balanced. The statement shown in Form 30 is a transcript of the bank's account with the depositor showing all credit and debit items. Many banks render such a statement to the depositor monthly.

Reconciliation of Depositor's and Bank's Accounts.—When the bank's statement of account or the balance as shown by the pass-book is received, it will seldom agree with the depositor's record for several reasons. So far as checks drawn are concerned, the depositor's record is more up to date than the bank's record. As soon as a check is written, it is entered on the stub of the check book. The bank, however, knows nothing of the checks drawn until they are presented for payment. Some checks are sent out of town, and others go through the local mail, not reaching the bank until the following day or often several days later. These outstanding checks cause the chief difference between the bank's record of the depositor's account and his own record.

Other transactions, however, also cause differences. If the depositor holds a customer's note due in a few days and places it with his banker for collection, the banker will not credit his account with the amount until it has actually been collected. Nor would the depositor charge the banker until he receives notice that the amount has been collected and placed to his credit. If the bank's statement should include this item and the depositor's statement not include it, manifestly there would be a difference between the two accounts. Again, it may happen that customer's checks deposited and accepted for credit to the depositor's account cannot be collected by the bank. The amount of the uncollected check is then charged back against the depositor's account. If the banker's statement takes account of this uncollectible check, while the depositor has not yet been notified of the failure to collect the item, there will evidently be a discrepancy between the two records. The depositor will, of course, take the matter up with the customer and attempt to collect the item.

Sometimes the banker allows interest on moneys deposited, and sometimes collection charges are made on checks and notes placed with the bank for collection. The banker, of course, knows both the interest which he will credit and the exchange or collection costs which he will charge to the depositor's account, whereas the depositor does not know them until notified by the bank. Thus a discrepancy will arise. These are the chief items that will give rise to a difference between the two accounts.

In checking one account against the other, the depositor must take all such items into consideration and make a reconciliation of the two accounts. For the purpose of safeguarding cash, it is best that the reconciliation be made by someone who does not draw the checks or make the deposits. This should prevent fraud except in case of collusion. The first thing to be done is to compare the deposit items shown by the pass-book or the monthly statement of account with the deposit items on the reverse stub of the check book. Items in one account which are not in the other will account for a difference to that extent. Next, the canceled checks which the bank has returned should be arranged in numerical sequence and compared with the stubs in the check book. Frequently each stub corresponding with a canceled check is marked with a large red or blue check mark. Those checks which the depositor has drawn but which have not yet been presented to the bank for payment will in this way become apparent. A list of these showing the check numbers and amounts should be made. A reconciliation of the two accounts may now be made.

Two methods are used. Under the one, the balance as shown by the bank is reconciled with the balance as shown by the depositor's record, that is, starting with the bank balance we adjust it to arrive at the depositor's balance. Under the other, we start with the depositor's balance and bring it into agreement with the bank's balance.

In the illustration following the first method is used. If the bank's balance includes a credit to the depositor's account of which he has not yet received notice, the bank's balance will be

larger by that amount than the depositor's record. Hence, the amount of such credit items—notes collected, interest credited, etc.—must be subtracted from the bank's balance. If there are any outstanding checks, manifestly, the bank's balance will be larger by the amount of these checks than that shown by the depositor's record. It is necessary, therefore, to subtract from the bank's balance the amount of the outstanding checks in order to arrive at the balance as shown by the depositor's record. When these adjustments have been made the two accounts should agree. An illustration will make most of these points clear.

Example. John Doe's balance as shown by his bank is \$631.20 as of February 28. A comparison of the depositor's record of deposits and the bank's record of deposits shows that the bank has credited to the depositor's account the following items for which the depositor has not yet received notice: A's note collected \$375, and interest credited for the month of February \$3.40. A comparison of the canceled checks with those which have been drawn, as shown by the depositor's check book stubs, shows that the following checks are outstanding: #496, \$100.25; #501, \$10.50; #505, \$6.75. The depositor's record shows that he has a balance in the bank of \$135.30. Reconcile the two accounts.

RECONCILIATION STATEMENT OF BANK ACCOUNT

February 28, 19—

Bank balance per pass-book (or statement)		\$631.20
<i>Deduct:</i>		
A's note collected but not yet entered in cash book . . .	\$375-	
Interest for February credited by bank but not yet entered in cash book	3.40	378.40
		<u>\$252.80</u>
<i>Deduct: Outstanding checks</i>		
Ck. #496	\$100.25	
#501	10.50	
#505	6.75	117.50
		<u>\$135.30</u>
Cash book balance.....		<u>\$135.30</u>

The student will understand, of course, that neither the bank's balance nor the depositor's balance will necessarily be the correct one. In the case above the bank has credited the depositor with a deposit which had not been recorded in the depositor's books. On the other hand, the depositor has a record of checks drawn against his deposit of which the bank has no knowledge. The purpose of the reconciliation statement is not necessarily to show the true balance available for checking, but primarily to check the correctness of both records. Two independent records of the same account—in this case one kept by the bank and the other by the depositor—provide the best proof of accuracy it is possible to secure. The reconciliation statement serves this purpose. If the depositor desires to know the true balance available for checking, he will take account of the deposits with which the bank credits him but which he has not yet recorded on his own books. His own records will then show the true status of his bank account.

In the example shown above, the true balance available for checking is \$513.70, made up as follows:

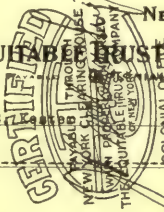
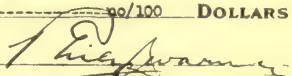
Balance as shown by depositor's record.....		\$135.30	
Add: Items credited by bank but not yet taken into the depositor's record:			
A's note collected.....	\$375-		
Interest for February.....	3.40	378.40	
True balance available for checking.....			<u>\$513.70</u>

Certification of Checks.—Certified checks are required for some business transactions and are desirable for many others. A **certified check** is one on the face of which is the bank's certificate that the check is good. The bank's statement that the check is good carries greater weight than does the individual's because the bank is a better known institution. Any check may be certified by presenting it to the bank in which the funds drawn on are deposited and having the bank's statement written or stamped

across its face that the check is good or that it is accepted. A form of certified check is shown in Form 32.

The legal effect of certification or acceptance of a check by the bank is that it and not the depositor now becomes liable for

PHILIP J. WARNER	No. <u>1785</u>	NEW YORK, <u>August 8th 1921</u> 192	
	THE EQUITABLE TRUST COMPANY OF NEW YORK 1-217		
	BRANCH 222 BROADWAY		
	PAY TO THE ORDER OF <u>Roy B. Keane</u>	<u>\$10.00</u>	
	Ten and ----- <u>no/100</u> DOLLARS		

Form 32. Certified Check

the payment of the check. To carry this liability into effect the depositor's account is charged as soon as the check is certified and the amount of the check is transferred to the general funds of the bank. When the check is presented for payment the bank's funds and not the depositor's will be used to meet it.

Either the holder or the maker of a check may present it for certification. A holder may desire to have a check certified, because he does not care to collect payment from the bank immediately or because he wishes to send the check through the mails to another party. When the holder has a check certified, the maker is absolutely released from all liability for payment.

The maker may desire to have his check certified before sending it to a creditor in order to make the funds immediately available for the creditor instead of compelling him to wait until the check can be collected by his bank. It is customary to deposit certified checks as evidence of good faith when bidding on a contract. If the drawer of a check has it certified he is not entirely freed from all liability inasmuch as the courts have held that he is still liable in case the bank fails before the check is presented for payment.

Cashier's Checks.—A cashier's check (Form 33) is a check on the bank signed by its cashier. In effect it is the bank's

CASHIER'S CHECK	1	NEW YORK <u>AUG 11 1921</u> 192__	No. <u>137918</u>
	IRVING NATIONAL BANK		W
	WOOLWORTH BUILDING		
	PAY TO THE ORDER OF	<i>W. F. Coney</i>	\$ <u>25</u> ⁰⁰
	<i>Twenty five</i>		DOLLARS
	COUNTER CHECK		
	<i>Bruckman</i>		<i>J. F. Lissner</i>
	100% PAID BY BANK		ASSISTANT CASHIER

Form 33. Cashier's Check

promise to pay on demand. It is current because of the bank's standing in business circles. It is generally used by the bank for making payment to those who are not depositors.

Certificate of Deposit.—A certificate of deposit (Form 34) is a statement generally signed by an officer of the bank, certifying that the named party has deposited money to the stated amount.

Certificate of Deposit	
Guaranty Trust Company of New York	
No. 1766	New York, <u>Sept. 7-21</u> \$ <u>1000</u> ⁰⁰
This Certificate is given to <u>David B. Reynolds</u> who has deposited with the Guaranty Trust Company of New York the sum of <u>One Thousand</u> Dollars in current funds payable with interest at the rate of <u>3</u> per cent per annum upon <u>31</u> days notice in writing to the <u>agent</u> <u>David B. Reynolds</u> or assigns upon surrender of this certificate, which is assignable only on the books of the company. The right is hereby reserved, upon giving ten days notice, which may be sent by registered mail to the address of the holder on the back of the company, to modify the rate, or discontinue the payment of interest, or to pay the principal.	

Form 34. Certificate of Deposit

Such a deposit is not subject to checking and usually earns interest for a definite period. It may be made payable on demand or at a stated time. Part payments may be entered on the back of the certificate or the old certificate taken up and a new one issued.

Spoiled Checks.—With proper care in writing checks few, if any, should be spoiled. When checks are spoiled, however, several methods of handling are used but either of the methods described will usually be satisfactory. The simpler method is to correct the stub record, destroy the spoiled check and use in its stead a new check detached from the back of the check book or secured from the bank which keeps loose blank checks (known as “counter” checks) for this and other purposes. Some concerns insist that no papers be destroyed. Here, the spoiled check is attached to its stub and marked “Void” or “Not Good” across the face and the signature, if made, is torn off and destroyed. If it is desirable for the cash disbursements journal to show in numerical sequence all checks, the spoiled check should be entered and adequate explanation (including reference to the new check issued in its stead) given, but no amount should be extended in the money column, through which a line is drawn to prevent any entry therein.

Collections.—In discussing deposits it was stated that checks of all kinds are received as deposits by banks. On the part of the bank this implies that the banker will present the checks to the banks on which they are drawn, and get money in return for them. Were it necessary for every business man to present all checks received to the various banks on which they are drawn, it would so complicate and delay the collection of the moneys represented by them that their efficiency for the transaction of business would be largely eliminated. The banks have accordingly built up the machinery for collecting these items for the business man. The bank is safe in doing this because every depositor guarantees

the collection of the items turned over to the bank for deposit. Banks not only collect checks, but also promissory notes, bond coupons, drafts, etc. Other valuable and important papers are often transferred through the bank's collection department. The banker usually makes a small charge for these collections, inasmuch as a great deal of work is involved and funds often have to be transferred by insured express in order to accomplish the collection. These charges are called "collection" and are usually a small fraction of 1% of the amount collected. A recent order of the federal reserve banks to all member banks will, it is hoped, have the effect of doing away with the collection charges on checks.

Stopping Payment.—A depositor has control over the payment of any check which he draws, up to the time it is presented at the bank for payment. If he finds that the check has been written in error, that the amount is wrong, that it has been issued fraudulently under a misapprehension, or if for any other reason he desires to prevent its payment, he may do so by written notification to his bank. He may telephone in order to stop payment, but legally a written notice is required. This notice must contain the date of the check, its number, amount, and the name of the payee, in order to enable the banker to identify the check. No one but the depositor has a right to stop payment on a check drawn by him.

Overdrafts.—When a depositor writes a check for a larger amount than he has on deposit in the bank, he is said to **overdraw** his account. It is contrary to good banking practice to permit this. An overdraft is in the nature of an open account loan made by the banker to a depositor, and unless a depositor's credit is high the overdraft will not be allowed. If a check is presented for payment in amount larger than the depositor's available balance, payment may be refused and the check returned with the bank's notification "Insufficient Funds," or

similar phraseology. If a depositor keeps accurate record of his bank balance, there is no excuse for overdrawing his account. The practice is bad and should never be resorted to excepting with the previous consent of the bank. The depositor should be willing to pay interest on all overdrafts.

Dishonoring Checks.—Checks are negotiable instruments and may be formally dishonored in the same way as promissory notes. In order to protect the rights of the various parties, formal notice of protest may become necessary. This procedure is explained in the previous chapters.

The Clearing House.—The clearing house is the means used by banks to collect checks and other items drawn on each other. Thus, if a person deposits in bank A a check for \$1,000 drawn on bank B, bank A collects the check for its depositor. In the course of the day's business, others also may have deposited in bank A checks on bank B, the total amount which bank A must collect from bank B being, at the close of the day, \$4,000, let us say. At the same time bank B may have received on deposit checks drawn on bank A for, say, \$2,500. Instead of bank A presenting all checks drawn on bank B and getting the money on them, and bank B presenting all checks drawn on bank A and getting the money on them, the two banks come together and find the difference between the two groups of checks. Canceling equal amounts, only the excess—\$1,500 due bank A in this case—has to be collected in actual money.

Where there are a large number of banks in a locality, they form a central clearing house to which all checks on other banks are sent in the custody of clerks for collection. Here, all of the checks drawn on bank A, let us say, and deposited in the other banks are balanced off against all of the checks on other banks which have been deposited in bank A, and bank A receives or pays in actual money only the differences. Thus there may be fifty bankers with claims against bank A, while bank A may have

claims against many or all of these same fifty banks. The money paid into the clearing house by the banks with adverse balances will be used to pay those banks which have favorable balances. In this way the banks do not make individual adjustments with each of the other banks, but with all of them combined. Accordingly, payments are not made by one bank to each of the individual banks which it may owe, but each bank pays its adverse balance to the clearing house, which in turn makes payment to member banks having favorable balances. The clearing house, therefore, as its name implies, serves as a place through which are cleared the claims of member banks against each other. Through the machinery of the clearing house the collection of checks and other items has been expedited and simplified to an almost unbelievable degree.

QUESTIONS

1. What is a bank?
2. Why has a bank more money than the original investment?
3. What is meant by "depositor"?
4. What is meant by "extending credit"?
5. Tell all you can about a bank's chief source of income.
6. What are the incidental sources of income for a bank?
7. Distinguish between commercial banks and savings banks.
8. Where does each of the following classes of banks get its authority to do business:
 - (a) National banks?
 - (b) State banks?
 - (c) Trust companies?
9. Explain briefly the general plan of the federal reserve banking system.
10. Explain briefly the plan on which each of the following savings banks is operated:
 - (a) United States postal savings bank
 - (b) State savings bank
 - (c) Mutual savings bank
 - (d) Stock savings bank

11. Explain the functions of the commercial bank.
12. Explain the functions of the savings bank.
13. Describe the procedure in opening an account with a business bank.
14. (a) What is a deposit ticket?
(b) How is it used?
15. (a) Why is it desirable to keep a copy of the deposit ticket?
(b) Should any additional information in regard to the deposit be kept? Why?
16. (a) What is the function of the bank pass-book?
(b) Describe its ruling.
17. Describe the procedure in withdrawing money from a commercial bank.
18. What are the five essential items of a check?
19. (a) Name two non-essential items of a check.
(b) Why are these two non-essentials oftentimes very convenient to have on a check?
20. (a) Name the parties to a check.
(b) What other names may be substituted for the name of a person as payee on a check?
21. Compare the check and the promissory note.
22. Describe the form of a check. Illustrate.
23. Describe the procedure in drawing a check.
24. How should a check for less than \$1 be filled out? Illustrate.
25. (a) What is an indorsement?
(b) What is its purpose?
26. (a) Name the principal kinds of indorsement.
(b) Illustrate each kind.
27. (a) Discuss alteration of checks.
(b) Discuss protection against alteration of checks.
28. Who suffers the loss if a bank pays a check:
(a) Having a forged signature?
(b) Having a raised amount?
29. Why is it important to keep a record of all dealings with a bank?
30. Why should the stub containing the essential memoranda of a check be written first?
31. Explain the transit number on a check.
32. (a) In what way can the transit number be used in connection with the record of deposits?
(b) In how much detail should the record of deposits be kept? Why?
33. (a) Why is the reverse of the check stub or interleaf a convenient place to record deposits?

(b) What are the advantages of totaling deposits and checks separately?

34. In what two forms do the bank's dealings with the depositor appear? Explain each.

35. What is meant by reconciliation of the depositor's account and the bank account?

36. What two methods of reconciliation are used?

37. Explain in detail the procedure for one method of reconciliation. Illustrate a reconciliation statement.

38. Does the reconciliation statement always show the true balance available for checking? Explain.

39. Illustrate the method for finding the true balance available for checking.

40. What is a certified check? Who may have a check certified?

41. Illustrate the form of certification.

42. (a) What is the purpose of certification?

(b) Advantage?

43. (a) What is a cashier's check? How used?

(b) Explain the purpose and use of a certificate of deposit.

44. Explain how spoiled checks should be handled.

45. (a) What service do banks render under the term "collection"?

(b) Of what advantage is that to the business man?

46. (a) How may payment be stopped on a check?

(b) What information must be furnished to the banks?

(c) Who may stop payment?

47. Discuss "overdraft" as applied to bank accounts.

48. In what way will accurate records of dealings with the bank prevent accidental overdrafts?

49. Under what conditions will checks be dishonored?

50. What is a clearing house?

51. Discuss briefly the operation of a clearing house.

52. What are the advantages of a clearing house?

PROBLEMS

1. On January 24, 19—, H. Sutherland draws check #115 on the Merchants National Bank of Cincinnati, Ohio, for \$260.53 in favor of F. H. Locke. Prepare the check.

2. On November 12, 19—, the Arcola Manufacturing Company draws check #865 on the Harrison Bank of Commerce, amounting to \$1,542.33 for pay-roll purposes.

- (a) Draw the check to the order of "Pay-Roll."
- (b) Give the entry to be made in the cash book of the company.

3. Edward Harrison, a high school teacher of Lancaster, Pa., has purchased books from the Macmillan Company of New York, amounting to \$115.39 which he remits by certified check #153, drawn on the Lancaster National Bank, dated April 23, 19—.

(a) Draw the check to be sent to the Macmillan Company, signing the maker's name.

(b) Show the check certified by the bank.

4. You have received a check on the Liberty National Bank of New York City, dated May 5, 19—, payable to the order of S. Brennan, who transferred the check by a blank indorsement to G. Edwards. The latter indorsed the check in full and transferred it to you. You now wish to transfer the check to James Harris, but you do not wish to be held liable for the payment of the check.

(a) Draw the check.

(b) Show the successive indorsements up to the time you received the check.

(c) Show the indorsement you would use.

5. On April 15, 19—, the cashier of the firm of Moore and Canfield has the following to deposit with the Guaranty Trust Company of New York: \$100 in large bills; \$80 in small bills; \$10 in silver; \$150 check on the Hanover Trust Co. (2-32); \$250 check on the Harriman National Bank (1-15).

(a) Prepare the deposit slip.

(b) Show the checks indorsed, using the restrictive indorsement.

(c) Prepare the record you would make of this deposit in your check book.

6. You, as manager of the Cleveland Trust Company, have received a letter from Charles Sommers of Cleveland, Ohio, dated November 15, 19—, informing you that he wished to open an account with your bank. Write a brief letter explaining what he must do to become a regular depositor of your bank.

7. On March 17, 19—, the Hamilton Trust Company of Paterson, N. J., informs George Radcliffe of the same city that a check amounting to \$169.75 and deposited by him on the 15th inst. has been found uncollectible because of insufficient funds to the credit of the maker, S. B. Wright. The check was drawn on the Hackensack National Bank, Hackensack, N. J., and was dated March 13, 19—.

- (a) Draw the check.
- (b) Give the entries to be made by Radcliffe in the cash book and the check book at the time the check is received.
- (c) At the time it is returned.
- (d) Would Wright make any entry when the check is found uncollectible? Discuss fully and give reasons.

Note: A check found uncollectible by the bank is returned by the bank to the depositor, and his account is charged on the books of the bank. When the depositor's pass-book is next balanced or the monthly statement of account is rendered, the bank includes with the canceled checks returned a "charge ticket" covering the uncollectible check charged against the account and previously returned to the depositor.

When the bank returns the check, the depositor will usually present it (in person, or by letter) to the maker for payment. If paid in cash by the maker, he should correct the original cash book entry of the check to show that payment was made by cash rather than by check. The check should be marked "Void" and the check book stub record corrected to show that that check was not paid by the bank. The maker may, however, have deposited sufficient funds in the meanwhile, and may ask that the check be presented to his bank for collection. In which event, the check may be sent direct to the maker's bank or deposited in the depositor's bank again and collected in regular course.

8. On September 15, 19—, H. Clafin, Inc., one of your creditors, returns your check #756, dated September 10, 19—, for \$253.62 and drawn on the Manhattan Exchange Bank of New York City, due to lack of signature.

(a) What would you do with the check upon its receipt from Clafin, Inc.?

(b) Give the entries to be made by Clafin, Inc., in their cash book and check book, assuming that they did not detect the lack of signature until it was called to their attention by the bank when they attempted to deposit it.

9. The Arrow Merchandise Company of New York City, makes the following deposits with the Mechanics National Bank of the same city:

19—

October 3	Total deposit	\$253.65
10	Total deposit	145.76
15	Total deposit	105.25
27	90-day note \$500 —	
	Discount—6% <u>7.50</u>	492.50

During the same month the following checks were issued:

#925	Carlton Silk Company	10/ 5	\$135.46
926	Holeproof Hosiery Company	10/ 5	146.55
927	Pay-Roll	10/10	450 -
928	S. Bradford	10/25	365.47

The balance on hand October 1 was \$465.28.

(a) Show these deposits and checks as entered on the check book stub.

(b) Reconcile the bank balance with the check book below.

10. On November 1, 19—, F. E. Camper of Kansas City, Kans., received his monthly statement from the bank in which his balance was represented as \$740.80. His check book showed a balance of \$543.65 on same date. In comparing the canceled vouchers with the check stubs he finds that the following checks were outstanding:

	Amount
#155	\$56.73
157	68.29
158	46.75
160	25.38

Prepare the reconciliation statement.

11. The cash book of the Nixon Specialties Company shows on July 1, 19—, a balance of \$12,901.67 in cash at the National Bank of Commerce. The bank, however, in its monthly statement shows their balance to be \$15,500. In comparing the canceled checks with the check stubs, their bookkeeper finds the following checks outstanding:

	Amount
#465	\$3,506.75
469	465.93
470	125.65

He also finds that a check on an out-of-town bank amounting to \$1,500, which was deposited on June 29, was not credited to the company by the bank. Reconcile the bank balance with the cash book balance.

12. The treasurer of the Harrison Manufacturing Company has received, January 31, 19—, a monthly statement from their bank, the Harrison National Bank, which shows that disbursements by check amounted to \$15,343.16 and deposits during the same period amounted to \$17,397.91. The bank represents the company's balance of cash on hand as \$2,054.75 while the cash book balance amounts to \$1,747.40. After

comparing the check book stubs with the canceled checks, he finds the following checks still outstanding:

	Amount
#816	\$135.63
820	45.65
825	129.42

According to the bank's statement interest on the bank balance has been credited to the firm amounting to \$12.40, while their account was charged with \$15.75 for collection items.

(a) Draw up the reconciliation statement.

(b) Give the entries to be made by the company to record the interest credit and collection charges.

13. On March 1, 19—, the Anderson National Bank represents the balance of the Barrett Grocery Company as \$2,513.55, while the firm's cash book shows a balance of \$2,444.12. Outstanding checks are as follows:

	Amount
#743	\$150.75
746	35.88
753	49.78

In examining the canceled vouchers the bookkeeper notices a charge ticket covering a check amounting to \$166.98 which had been deposited and returned uncollectible. He had failed to make a correcting entry at the time the check was returned. The check was made by H. Adams, one of their customers.

(a) Prepare the reconciliation statement.

(b) Give the correcting entry.

14. Dr. R. McPherson cannot reconcile his check book balance with the balance as shown by the bank statement. He asks you to help him find the trouble.

His bank balance amounts to \$495.65, while according to his check book the balance is \$387.27 for the same period. According to his pass-book the total deposits amount to \$850.75 and canceled vouchers amount to \$355.10. His check book shows total deposits for the same period to be \$832.75 and checks disbursed to be \$436.48.

Upon investigation you find that the bank's deposit figure is correct, the doctor having entered a \$52 check on his check book stub as \$25 when recording his deposits.

The following checks are still outstanding:

	Amount
#154	\$35.63
155	45.75

- (a) Prepare the reconciliation statement.
- (b) Explain the difficulty.

15. A series of transactions to be recorded in the blank books provided—continued from Problem 14, Chapter XXV.

This represents the second month of the first quarter of Mr. Thatcher's business for 19—.

February, 19—.

1. Received check for \$58.20 from Amos K. McBride for balance owed us December 31. Rented office space in our store to William H. Powell. He paid in advance for the month by check \$60.
4. Sold merchandise to Roy A. Parks, Omaha, Neb., \$2,425. terms 2/20, n/40.
6. Bought \$3,795.80 in merchandise from Chester Pierce, St. Paul, Minn., terms 3/20, n/60.
7. Sales of merchandise for cash to sundry customers \$17,372.65.
8. Amos K. McBride sent us New York exchange consisting of draft for \$632 drawn by the First National Bank of Pittsburgh, Pa., E. J. Turner, Cashier, on the Chemical National Bank of New York, February 6, 19—, in payment of his 30-day note of January 9.
9. Sent our certified check for \$904.50 to Chester Pierce, in payment of our 30-day note for \$900 of 1/10/— and accrued interest.
11. Roy A. Parks returned \$300 of merchandise from sale #5, claiming part of the order had been filled twice. Upon investigation we found his statement correct and sent him credit memorandum for \$300.
12. Paid in cash: office salaries \$300; salesmen's salaries \$225.
14. Paid Foster Brothers by check for stationery and other office supplies \$43.75.
15. Craig and Drury of Baltimore, Md., became bankrupt some time ago and at a meeting of the creditors it was agreed to accept 30 cents on the dollar. Today we received a certified check for \$146.55, drawn on the Union Trust Company of Baltimore by

their attorneys, Daniels, Sims and Wood, in full settlement of our account. (The loss on this account should be transferred to Bad Debts account, and carried there until the ledger is closed.)

17. Sold merchandise to Homer Welbrun \$3,457.35, terms 2/30, n/60. Deposited in the bank coupons from Liberty bonds \$24.50. This includes the accrued item of \$18.50 of December 31.
18. Purchased from H. M. Scott and Company \$2,867.40 in merchandise, terms 3/20, n/60.
21. Received from H. M. Scott and Company credit memorandum for \$155, covering our claim for allowance on invoice of 2/18/— for goods damaged through faulty packing.
24. Roy A. Parks sent us check in full for sale #5, less discount. (Part of this sale was returned on the 11th.)
25. Gave Chester Pierce check for invoice #5, less discount. Cash sales to sundry customers \$8,926.85. Cash purchases from sundry creditors \$14,371.10.
27. One of our cash customers of the 25th proved that we overcharged him \$100. We sent him check for that amount.
28. Paid by check \$36 for insurance policy #18643 issued by the Hudson Insurance Company covering stock of merchandise. Paid cash for cleaning windows and scrubbing \$8.40. Mr. Thatcher withdrew cash for personal use \$860. Gave —— Railroad check for freight \$238.16. Distribute \$176.47 to Purchases; balance to Sales. Paid cash for telephone and telegraph bill \$15.80.

(a) Record all the above transactions in the various journals.

(b) Summarize the cash, sales, and purchase journals and balance the cash book.

(c) Post and obtain a trial balance, recording it on pages 32 and 34 of the journal blank, heading the fifth and sixth columns, "Feb. 28, 19—." (This problem is concluded in Problem 14, Chapter XXVII).

CHAPTER XXVII

BILLS OF EXCHANGE—DRAFTS

Purpose of Chapter.—

1. Form and content of drafts.
2. Acceptance and protest of drafts.
3. Bookkeeping entries for drafts.
4. Form and content of trade acceptances.
5. Advantages over open accounts.

Origin of Drafts.—It is not definitely known when drafts first came into use. There is some evidence that the Greeks and Romans used certain forms of drafts. It is said that Cicero remitted money to his son in Athens by means of a draft. Bills of exchange were used in Italy in the thirteenth century and found their way into England shortly after. The foreign bill of exchange was used before the domestic or inland bill. Following the dark ages, during which there was little intercourse between nations, came a period in which trade and intercourse sprang up again. However, travel was hazardous and the shipping of goods and especially of moneys was fraught with danger. The draft, or bill of exchange, came into use at this time largely to do away with the hazards attendant upon the transfer of funds for the settlement of debts between merchants. Only after many years of use, however, did the laws of the various countries give legal status to the business customs and procedure which grew up around its use. This code of law is spoken of in the great body of English law as the "Law Merchant," from the fact that it developed from the practice of merchants.

Purpose of the Draft.—The use of the draft is illustrated by the following transactions. Jones, a grain merchant of Chicago,

has shipped a cargo of grain to Green Brothers, of Norfolk, who are thus in debt to him. However, Green Brothers have a claim against the Jackson Company, of New York, for commodities sent to it some time ago. In order to pay Jones the amount they owe him, Green Brothers transfer to Jones as much of their claim against the Jackson Company as is necessary to settle with Jones. In other words, Green Brothers write the Jackson Company, asking them to pay to Jones, of Chicago, a certain amount of their debt to Green Brothers. An informal draft or a request made by one party to the other to make payment may be illustrated by the following letter:

Norfolk. Va.,
November 25, 1921.

THE JACKSON COMPANY,
New York, New York.

GENTLEMEN:

Kindly pay to Jones of Chicago One Thousand Dollars (\$1,000) and charge to our account.

Very truly yours,
GREEN BROTHERS.

The purpose of the draft, therefore, is to settle debts through transferring claims by means of a written order. There is a manifest saving in this since funds do not have to be transferred among the various parties, but only the unpaid balance remitted to settle the debts arising out of the two transactions. The draft transaction is really an application of the clearing house method explained in connection with checks. In general we may say that the use of the draft arises from a transaction entered into for the purpose of settling a debt where the transfer of funds would be necessary.

Kinds of Drafts.—Drafts are classified on several bases:

1. Geographically as to place
2. As to time of payment.
3. As to the parties.

1. Classified geographically as to place, drafts are:

- (a) **Domestic, or inland, drafts**, drawn and payable within the same state.
- (b) **Foreign drafts**, drawn in one state but payable in some other state or foreign country.

Thus a draft drawn in New York and payable in Chicago becomes a foreign draft. Similarly, a draft drawn in New Orleans and payable in Brazil is a foreign draft. A draft drawn in San Francisco but payable in Los Angeles is, however, a domestic, or inland, bill.

2. Classified as to time of payment, drafts are:

- (a) **Sight drafts**, which are to be paid when first seen by the parties on whom they are drawn.
- (b) **Time drafts**, to be paid some time after they are presented or seen.

Time drafts may be drawn for a certain number of days after sight or after date. When a draft is payable after sight, it is important that the party on whom it is drawn be found and presented with or shown the draft in order to establish the date from which the date of payment is determined. A draft payable a certain time after date, however, has its payment date determined by counting forward from the date on which it was drawn.

3. As to the names of the parties, drafts are sometimes classified as bank drafts or commercial drafts. If one bank requests another bank to make payment, the request is a **bank draft**, whereas if one merchant requests another merchant to make payment, the request is a **commercial draft**. Except for the transaction of foreign business, the commercial draft is little used at present.

The Parties to a Draft.—By reference to the informal letter of request above, the student may become familiar with the titles given to the various parties. The party making the request, in this case Green Brothers, is called the **drawer**, the one who draws

the draft or request. The party to whom the request is made, in this case the Jackson Company, is the **drawee**, the one on whom the draft is drawn. The party in whose favor the request is made, in this case Jones, of Chicago, is called the **payee**.

Since the draft transaction arises from the transfer of funds for the settlement of debts, therefore it presumes there is a debtor and creditor relationship between the parties. For example, the Jackson Company, of New York, owes Green Brothers, of Norfolk, who in turn owe Jones, of Chicago. The accepted draft, however, is a negotiable instrument, and as such has all the guaranties of the promissory note. For example, if the Jackson Company agrees to the request made of them by Green Brothers, they become primarily liable to Jones, of Chicago, who may now look to them and even enforce at law the claim which he now has against them. Although there was originally no debtor and creditor relationship between them, the accepted request establishes it, inasmuch as the three parties have now agreed to settle their respective debts or some portion of them in this way.

Content of the Draft.—The draft in order to be a negotiable instrument:

- i. Must show the place and the date of the draft or request.
2. Must contain a written order, usually in the words "Pay to the order of," or "Pay to bearer."
3. Must give a definite or determinable date when the request is to become effective, either:
 - (a) At sight, or
 - (b) At a certain time after sight or after date.
4. Must give the name of the payee to whom payment is to be made.
5. Must name the amount of the payment in both words and figures.
6. Must be signed by the party making the request, that is, the drawer.

7. Must give the name and address of the party to whom the request is made, that is, the drawee.
8. To be binding and negotiable must show on its face that the drawee agrees to the request made on him. This is absolutely essential.

Form of the Draft.—The following draft forms are standard and should be compared with the informal letter of request above. The main difference is in the position of the drawee's name and address. Instead of being in the upper left-hand corner, it is placed after the body of the letter in the lower left-hand corner preceded by the word "To." The salutation "Gentlemen," or "Dear Sirs"—is omitted. Save for these slight differences, the formal draft is the same as the informal request. Form 35(a)

<u>\$250⁰⁰</u>	<u>New York</u>	NOV 26 1921	<u>1921</u>
<u>At sight</u>		<u>Pay to</u>	
<u>the order of J. Richard Huling</u>		<u>Dollars</u>	
<u>Two Hundred Fifty</u>		<u>Dollars</u>	
<u>Value received and charge the same to account of</u>			
<u>To Gordon Jones</u>		<u>Wm Price</u>	
<u>No. Buffalo N. Y.</u>		<u>Wm Price</u>	

Form 35. (a) Sight Draft

<u>\$348³⁵/₁₀₀</u>	<u>New York</u>	Nov. 22	<u>1921</u>
<u>thirty days after sight</u>		<u>Pay to</u>	
<u>the order of Russell H. H. H. H.</u>		<u>Dollars</u>	
<u>Three hundred forty eight & 35/100</u>		<u>Dollars</u>	
<u>Value received and charge the same to account of</u>			
<u>To John D. Williams</u>		<u>Paul P. Stewart</u>	
<u>No. 27. Winona, Minn.</u>		<u>Paul P. Stewart</u>	

Form 35. (b) Time-after-Sight Draft—Accepted

\$94 ~~XX~~	New York, August 15, 1921.
Accepted August 15, 1921.	Sixty days after date
Pay to the order of	Pay to
Ninety- ~~XX~~	more Mitchell
	Dollars
Value received and charge the same to account of	
To Charles W. Hamilton	D. H. Chesterfield
No. 43 Cadillac, Mich.	

Form 35. (c) Time-after-Date Draft—Accepted

gives the sight draft, Form 35(b) a draft payable at a definite time after sight, and Form 35(c) a draft payable after date. The student should compare these draft forms with the two bank check forms illustrated in Chapter XXVI. Note that in the case of the check the drawee is always the bank of deposit, that is, the bank in which the maker of the check keeps his funds. The drawee's name is at the head of the check in one case, while in the other it follows the form of the draft and appears in the lower left-hand corner. The names of the payee and the drawer appear in both the check and the draft at relatively the same places. Since the check is always a sight draft, the words "at sight" need not appear in it. Since a draft may be either sight or time the wording must indicate which it is.

Definition of the Draft.—As defined by the negotiable instrument law, a **bill of exchange** is "an unconditional order in writing addressed by one person to another, signed by the person giving it (drawer) requiring the person to whom it is addressed (drawee) to pay upon demand or at a fixed or determinable future time a sum certain in money to order or to bearer (payee)."

The Acceptance of a Draft.—The formal draft and the informal letter are nothing more than requests. Under the circumstances cited in the example above, there is usually no

reluctance or hesitation on the part of the drawee to make payment as requested. Unless, however, the debtor-creditor relationship existed between the drawee and drawer, the drawee would not be willing to pay another man's debts. Hence, to be binding at law, it is essential that the drawee signify his willingness to make payment as requested in the draft. Without such written acceptance, the draft has no more legal status than an ordinary request. This acceptance by the drawee binds him to the contract as stated in the draft and makes him primarily liable. The acceptance must be in writing and signed by the drawee. It is customary to give the date of acceptance also. This is especially important in the case of a time-after-sight draft, inasmuch as the date of acceptance is the basic date from which the due date is determined.

Acceptance is usually signified by writing across the face of the draft the word "Accepted" and the date, followed by the signature of the drawee. The banks frequently act as intermediary parties in securing acceptances. Thus in the illustration shown, Green Brothers, of Norfolk, draw a draft on the Jackson Company, of New York, but instead of sending it to the Jackson Company for acceptance, send it to Jones, of Chicago, who either through the mails or through his bank presents it to the Jackson Company, of New York, for acceptance. Upon acceptance the draft is returned to Jones, of Chicago, who holds it as a negotiable claim against the Jackson Company, of New York. If upon presentation of the draft for acceptance, the drawee refuses to accept, it must be returned. The drawee has a legal limit of 24 hours in which to accept or to refuse and return the draft. If he destroys it or refuses to return it, he will be deemed at law to have accepted it.

Acceptances are of two kinds: a general or unconditional acceptance, in which the above form is used, and a qualified acceptance. A **qualified acceptance** is one in which the full terms of the contract as stated in the draft are not accepted but some alteration is made in them before accepting. Thus the drawee

might state in his acceptance that he will pay only a part of the amount for which the bill is drawn, that he will pay at a particular place, that he will pay at some other time than the time stated, or that he will make his payment dependent upon the fulfilment of some condition stated in the acceptance. A draft with a qualified acceptance is not so easily negotiable as one with a general or unconditional acceptance. Forms 35(b) and 35(c) above show drafts with acceptances.

Maturity of Drafts.—Sight drafts are payable at once. Time-after-sight drafts are payable at the agreed time after sight, time beginning to run from the date of acceptance. The date of maturity is figured in the same way as the date of a promissory note is figured. If time is stated in months, calendar months are implied. On time-after-date drafts, presentation to the drawee for acceptance need not be made until at or slightly previous to the date of maturity. If, however, the payee desires to negotiate the draft to another party, prior to date of maturity, it is better for the draft to bear the acceptance of the drawee. Accordingly, it is good business practice to secure the acceptance of all drafts as soon as possible.

The Collection Draft.—The draft is often used as a “dun” for the collection of past-due accounts. Sales are frequently made under a contract somewhat as follows: 2%, 10 days, net 30. (2/10, n/30), subject to sight draft without notice. This means that the seller of the goods will draw a sight draft on the customer if payment is not made at the time agreed upon. Such a draft is usually made payable to the drawer’s bank or to “Ourselves,” the drawer and the payee being one and the same party in the latter case. The draft is usually handled through the drawer’s bank, which will send it either direct to the drawee or to its correspondent bank at the drawee’s address for presentation and collection.

This draft, being nothing but a request, has no stronger legal

status than any other request for payment of a debt. The dishonoring of such a request by the drawee, however, casts discredit on him and reflects on his credit standing among the banks in his own community. On the other hand, it may happen that the drawee has a greater claim against the drawer because of unsatisfactory goods or past claims not satisfactorily settled. In such a case, the drawee's refusal to pay should not discredit him. The dunning draft has become so common that debtors who know its purpose and legal status pay no more attention to it than to a letter from the creditor requesting payment.

Collection drafts are never accepted by the bank as deposits to the drawer's account. They are accepted for collection only

NO PROTEST TEAR THIS OFF BEFORE PRESENTING.	\$ <u>125⁴⁰</u>	New York, <u>October 21</u> 19 <u>21</u>
	Order of IRVING NATIONAL BANK NEW YORK	
	PAY TO THE	
	<u>One Hundred Twenty-five & 40/100</u> Dollars	
	Value received and charge same to account of	
To <u>Kean & Dennis</u>	<u>Rogers, Hughes & King</u>	
Address <u>830 Western Ave.</u>		
No. <u>45</u> <u>Wichita, Kansas</u>		

Form 36. Collection Draft

and will be credited only when and if collection is made. Form 36 is a typical form of collection draft.

C.O.D. Collections and Accounts.—Another type of draft is frequently used for the collection of amounts where C.O.D. (cash on delivery) sales are made to parties whose credit standing is poor or unknown. Where the goods are not to be delivered locally, any of the three agencies may be used, viz., parcel post, express, or freight. The post-office handles C.O.D. transactions, collecting the amount stated and remitting it to the seller. The seller must, of course, prepay the postage, the cost of which, how-

ever, may by agreement be collected from the customer. When the express company is used, an abstract or summary, showing only the amount to be collected of the invoice sent to the customer, is given to the express company. It places this in a C.O.D. envelope, which is then attached to the package to be delivered. The express agent at destination collects the amount called for by the abstract of invoice, delivers the goods, and remits, usually by express money-order, direct to the seller the amount collected. The express and collection charges may, by agreement, be paid either by customer or seller.

Where goods are shipped by freight C.O.D., instead of the straight bill of lading, the shipper must secure an **order bill of lading** (Form 37) from the railroad. This differs from the straight in that it is in addition an order to the freight agent at destination not to deliver the goods until claimed by the party holding the order bill of lading. The shipper, after securing the order bill from the railroad, draws a draft on the customer, attaches the order bill of lading, and gives both documents to his bank for collection. The bank sends both to its correspondent bank at the point of destination, which correspondent collects the draft from the customer and then delivers to him the order bill of lading. The customer may now present the order bill to the railroad and secure the goods. The correspondent bank remits the amount collected (less collection charges) and this is placed to the credit of the seller's bank account. It will be noted that goods shipped by freight C.O.D. are not sent directly to the customer but to the order of the bank with instructions to notify the customer. When the customer pays the draft the bank indorses the order bill to him. The order bill is made out in sets of three just as the straight bill.

In recording C.O.D. sales, either they may be charged to customers, just as regular sales, a memorandum file being maintained to indicate the goods out on C.O.D. terms at a given time, or all such sales may be charged to a "C.O.D." account in which the various customers' names will appear in the explanation

column. When collections are made the corresponding credits will be entered on the same lines as the debits. The account balance, normally a debit, shows the amount of uncollected C.O.D. sales.

C. O. D.

19—					19—				
Oct.	1	J. Thompson	S 17	1,000	—				
	3	U. S. Grand	S 19	250	75	Oct.	4	U. S. Grand C.	10 250 75
	7	A. C. Pickard	S 29	475	90				

Goods sold C.O.D. for local delivery are usually handled differently. At time of sale a C.O.D. invoice or a regular invoice with C.O.D. tag or ticket is made out, the package is plainly marked "C.O.D." by the wrapper and sent to the delivery department. Here it is charged on a C.O.D. record sheet to the driver getting it, who must account for it either with the money collected or the package returned. When the money is turned over to the cashier, the sale will be recorded as a regular cash sale. It will be seen that in the interim between sale and collection the transaction is held "on the memorandum" by the delivery department.

Dishonored Drafts.—Drafts are dishonored by non-acceptance. If the drawee refuses to accept a draft drawn on him, it is necessary, in the case of a foreign bill, to make formal protest in order to hold the drawer and any indorsers. Protest is not necessary in the case of a domestic or inland bill. Since it is not necessary, in the case of time-after-date drafts, to make presentation for acceptance until maturity, the draft may bear the indorsements of several parties to whom it has been transferred. To hold them, formal protest must be made. The procedure of protest for non-acceptance is the same as in the case of notes, discussed in Chapter XXV. An accepted draft becomes to all intents and purposes a promissory note. It constitutes the

drawee's promise to pay. The liability of the drawer corresponds with that of the first indorser of a promissory note. Regular indorsers on a draft take rank after the drawer. Protest for non-payment of an accepted draft is, of course, just as necessary as for the non-payment of a note and the procedure is identical. The student should distinguish carefully between protest for non-acceptance and protest for non-payment. Collection drafts frequently carry on a perforated margin at one end the words, "No protest, tear this off before presenting." This is an instruction to the bank that the expenses of protesting the draft are not to be incurred in the event of the drawee's refusal to accept. The perforated slip should be torn off before presentation to the drawee, inasmuch as it is an instruction to the banker and not to the drawee. (See Form 36.)

Bookkeeping Entries for Draft Transactions.—Inasmuch as a merchant may be at different times the drawer, drawee, and the payee of drafts, it will be necessary to consider the entries to be made under these different heads. The following draft will be used for illustration:

No. 27	Syracuse, New York, July 5, 19 21
At sight	Pay to the order of
James Rogers and Company	\$500
Five hundred	Dollars
Value received and charge to account of	
To Rodney MacDougal New York, New York.	John Squires

1. On the Books of the Drawer.—The drawer's entries will be considered under two cases: (1) when the draft is drawn, (2) when the draft is protested for non-acceptance.

Case 1. (a) When Drawer and Payee Are Different Parties.

When the draft is drawn, the payee being a third party, James Rogers and Company, the drawer, John Squires, will debit the payee, James Rogers and Company to show the settlement of his debt to them, and credit the drawee, Rodney MacDougal, to show that MacDougal settled the debt he owed to Squires. Analyzed in basic terms, the transaction results in the decrease of the liability of Accounts Payable owed to Rogers and Company, and the decrease of Accounts Receivable, consisting of Squires' account against Rodney MacDougal. The entry would be:

James Rogers and Company (Payee).....	\$500 -	
Rodney MacDougal (Drawee).....		\$500 -
Gave James Rogers and Company our sight draft on Rodney MacDougal to apply on account.		

Case 1. (b) When Drawer and Payee Are the Same Party.

In case the drawer and the payee are the same party, the draft reading "Pay to the order of ourselves," and being used for collection purposes, no entry will ordinarily be made by the drawer until he has received notice that the draft has been collected, when the following entry will be made:

Cash.....	\$499.50	
Collection and Exchange.....	.50	
Rodney MacDougal (Drawee).....		\$500 -

We have assumed that the bank's charges for collection were 50 cents.

Case 2. When the Draft Is Protested for Non-Acceptance.

When the draft is protested for non-acceptance, the drawer will be restored to the same relation with the other parties which he held before drawing the draft. The original entry must now be reversed, as follows:

Rodney MacDougal (Drawee).....	\$500 -	
James Rogers and Company (Payee).....		\$500 -

Inasmuch as the draft was presented for acceptance by James Rogers and Company, they had to stand the expense of protesting. They will charge this against John Squires, the drawer of the draft, who will accordingly make an entry as follows:

Expense (or Protest Fees)	\$2.50	
James Rogers and Company (or Cash)		\$2.50

If he reimburses Rogers and Company immediately for the expense of protesting, the credit item in the above entry will be to Cash instead of to James Rogers and Company. If the draft was for collection and the payee and drawer were the same person, no entry will be necessary if the draft is protested, since no entry was made at the time it was drawn. Payment of the draft by the drawee at maturity does not affect the drawer, and so no record is necessary. If, however, the accepted draft is protested for non-payment at maturity, the entries for such a transaction are the same as for the protested promissory note explained in Chapter XXV. In this case the entry would be:

Rodney MacDougal	\$502.50	
Cash		\$502.50

2. On the Book of the Payee.—The transaction is now being recorded from the standpoint of James Rogers and Company, the payee.

Case 1. When the Draft Is Received. When the draft is received by the payee, James Rogers and Company, the following entry may be made for a sight draft:

Cash	\$500 -	
John Squires (Drawer)		\$500 -

This entry records an increase in the asset, Cash, and a decrease in the asset, Accounts Receivable, in the form of the reduction of Rogers and Company's account against John Squires.

When a time draft is received the following entry is made:

Notes Receivable.....	\$500 -	
John Squires (Drawer).....		\$500 -

This has the effect of increasing the asset, Notes Receivable, consisting of the drawee's written promise to pay after acceptance, and a decrease in the asset, Accounts Receivable, account against John Squires.

Since this is a sight draft the payee may wait until the draft has been collected, or make the entry as soon as the draft is received. Sometimes this entry is deferred until the draft has been presented to the drawee for acceptance. Theoretically this latter method is better, inasmuch as drafts prior to acceptance are not promises to pay, that is, notes receivable. Practically, however, the entry as given keeps track of the draft.

Case 2. When the Draft Is Paid. When the draft is paid at maturity, the following entry will be made:

Cash.....	\$500 -	
Notes Receivable.....		\$500 -

3. If the Draft Is Dishonored. If the draft is dishonored for non-acceptance or non-payment and the entry indicated under case (1) has been made previous to dishonoring, the reversing entry will be:

John Squires (Drawer).....	\$500 -	
Cash.....		\$500 -

or

John Squires (Drawer).....	\$500 -	
Notes Receivable.....		\$500 -

An additional entry will be made to record the payment of protest fees incident to the dishonored draft:

John Squires (Drawer).....	\$2.50	
Cash.....		\$2.50

Assume that the cost of protest is \$2.50. Note that this is charged to Squires, as it is an expense which he, and not James Rogers and Company, should bear.

3. On the Books of the Drawee.—Let us now consider the transaction from the standpoint of the drawee, Rodney MacDougal.

Case 1. (a) When Draft Is Paid Prior to Acceptance. If a sight draft is presented or if a time draft is not presented for acceptance until its date of maturity, the following entry will be made by the drawee if he honors the draft:

John Squires (Drawer)	\$500 -
Cash	\$500 -

The debit to John Squires (Drawer) indicates a decrease in the liability of Accounts Payable of \$500 represented by the amount owed to Squires on account, and the credit to Cash indicates a decrease in the asset, Cash, of \$500.

Case 1. (b) When Draft Is Accepted. If the above draft is a time draft and it is presented to the drawee, MacDougal, for acceptance and he accepts it, the following entry will be made on his books:

John Squires (Drawer)	\$500 -
Notes Payable	\$500 -

The debit to Squires records the decrease in the liability of Accounts Payable, account owed to John Squires, previously set up at the time purchase was made from Squires. The credit to Notes Payable indicates an increase in the liability of written promises to pay money to take the place of the former liability under the open account with Squires. If for any reason MacDougal refuses to accept the draft, he makes no entry on his books, since the original record of the transaction still holds.

Case 2. When an Accepted Draft Is Paid. When MacDougal pays the draft at maturity he will make the following entry:

Notes Payable.....	\$500 -
Cash.....	\$500 -

This indicates a decrease in the liability of Notes Payable and a decrease in the asset, Cash. It will assist in the understanding of these entries always to bear in mind the purchase or the sales transaction which preceded the draft transaction.

Summary of Entries.—Under most conditions the entries made by the various parties to a draft are as follows:

Drawer's:

Payee.....	\$....
Drawee.....	\$....

Payee's:

Cash (or Notes Receivable).....	\$....
Drawer.....	\$....

Drawee's:

Drawer.....	\$....
Cash (or Notes Payable).....	\$....

The Trade Acceptance.—A form of draft which is coming into frequent use is called the **trade acceptance** to distinguish it from the financial draft, whose purpose is merely the transfer of funds without regard to their source or to the transactions out of which the debtor and creditor relationship arises. The purpose of the trade acceptance is largely to do away with the open account. Thus, when a purchase and sale transaction takes place, instead of setting up a charge against the customer on the seller's books, the use of a time draft, called in this case a "trade acceptance," will bring about a charge to Notes Receivable instead of to the customer's account. There are many disadvantages in the use of the open account and many abuses have crept in. The method of selling goods by extending credit on open

account is not used to any extent in any other country. At the time of the sale the customer makes formal promise to pay at a definite future date, this promise usually taking the form of an accepted draft, payable at the end of the credit term allowed. Effort is being made by bankers, credit men, and associations of merchants and manufacturers to introduce this method into our country.

The Federal Reserve Board has laid down the following requirements covering the trade acceptance:

1. It must have arisen out of an actual commercial transaction, usually the purchase and sale of commodities.
2. It must have been drawn under a credit opened for the purpose of conducting or settling accounts resulting from business transactions involving the shipment or storage of goods.
3. At the time of presentation to the bank for discount or as collateral for the loan of money, it must have a maturity of not more than 3 months exclusive of days of grace.

Forms of Trade Acceptances.—Two standard forms of trade acceptances are in use, one approved by the Federal Reserve Board (Form 38a), the other by the American Acceptance Council (Form 38b).

TRADE ACCEPTANCE	
No. <u>243</u>	<u>Mobile, Ala., Mar. 10,</u> 1922
To <u>Wm. H. Chapman</u>	<u>Newark, New Jersey</u>
(NAME OF PAYEE)	(ADDRESS OF DRAWEE)
On <u>May 9, 1922</u>	Pay to the order of <u>Ourselves</u>
(DATE OF MATURITY)	(NAME OF PAYEE)
<u>Eighty-nine & 40/100</u>	<u>Dollars (\$89.40)</u>
The obligation of the acceptor hereof arises out of the purchase of goods from the drawee. The drawee may accept this bill payable at any bank, banker or trust company in the United States which he may designate.	
Accepted at <u>Newark, N. J.</u> on <u>Mar. 14, 1922</u>	} <u>Frank. L. Munson & Co.</u>
Payable at <u>First Nat. Bank</u>	
Location <u>374 Broad Street</u>	
<u>Wm. H. Chapman</u>	By <u>A. B. Winter</u>
(SIGNATURE OF ACCEPTOR)	

Form 38. (a) Trade Acceptance Approved by Federal Reserve Board

TRADE ACCEPTANCE FORM APPROVED BY THE AMERICAN ACCEPTANCE COUNCIL	No. <u>872</u>	<u>Akron Ohio</u> (CITY OF DRAWER)	NOV 22 1921 (DATE)	192
	ON <u>JAN 21 1922</u> (DATE OF MATURITY)	PAY TO THE ORDER OF OURSELVES		
	<u>Eleven Hundred Thirty</u> (AMOUNT IN WORDS)	<u>875.00</u> (AMOUNT IN FIGURES)	DOLLARS (\$ <u>1136.75</u>)	
	THE OBLIGATION OF THE ACCEPTOR HEREOF ARISES OUT OF THE PURCHASE OF GOODS FROM THE DRAWER. THE DRAWEE MAY ACCEPT THIS BILL PAYABLE AT ANY BANK, BANKER OR TRUST COMPANY IN THE UNITED STATES WHICH SUCH DRAWEE MAY DESIGNATE.			
	TO <u>John T. Roswell</u> (NAME OF DRAWEE)	<u>1881 Broadway</u> (STREET ADDRESS)	<u>New York</u> (CITY OF DRAWER)	<u>Nov 26 1921</u> (DATE)

Form 38. (b) Trade Acceptance Approved by American Acceptance Council

The trade acceptance is practically identical with the draft, the chief difference being the inclusion of a statement on its face to the effect that it has arisen out of an ordinary commercial transaction, usually the purchase of goods. It is drawn at the time goods are sold and takes the place of an open account with the customer. The ordinary draft is drawn at any time and has no necessary relationship to a purchase of goods, although the debtor and creditor relations between the parties may originally have arisen out of a purchase and sale of goods. In the case of the trade acceptance the drawer is also the payee, since he has sold goods and in drawing the draft makes the order for payment to himself. The drawee is then the customer.

Definition of the Trade Acceptance.—The Federal Reserve Board defines a **trade acceptance** as “a bill of exchange drawn by the seller on the purchaser of the goods sold and accepted by such purchaser.”

Disadvantages of the Open Account.—Experience of merchants with the open account shows that in the majority of cases the customer does not strictly regard the terms of sale given him at the time of his purchase. Thus, if a sale has been made on the basis of 2/10, n/30, merchants report that the 2% is taken on the basis of anywhere from 10 to 15 days' time, and that the extreme

credit of 30 days granted is extended to anywhere from 40 to 45 days before payment is made. Little or no compulsion can be brought to bear on the customer. If suit is ultimately brought to recover for the goods sold, the merchant must prove delivery of the goods, terms of sale, and the quality and quantity of the goods delivered. All of these items are open to dispute by the customer. Legal recourse is costly and time-consuming.

Open accounts cannot ordinarily be used as the basis for credit. If a merchant has a large amount outstanding with customers, he cannot take these open accounts to his banker and discount them so as to receive working funds for carrying on his business. There is a group of illegitimate bankers who discount open accounts, but the practice is frowned upon by legitimate bankers and is considered by them as evidence of the borrower's financial weakness and therefore impairs his standing in legitimate financial circles.

Advantages of the Trade Acceptance.—

1. *To the Seller.* The seller of goods whose claims against his customers are in the form of accepted drafts instead of open accounts can take them to a legitimate banker, discount them, and receive funds for them. The banker is willing to do this because the trade acceptance indicates on its face that it has arisen from a bona fide sale and should, therefore, be paid in accordance with its terms. The banker has a primary claim against the customer and a guaranty of that claim by the merchant. This is called "two-name" paper as distinguished from the promissory note which is usually "one-name" paper. The seller can thus be furnished with funds to carry on his business and is able to do a larger volume of business than if he were wholly dependent upon his own capital. The trade acceptance being a negotiable instrument, in case suit has to be brought on it the burden of proving the circumstances of the transaction is not placed on the merchant but on the customer, who must show that the sales contract was not lived up to by the merchant. The trade ac-

ceptance having been transferred to the banker, the customer must pay it in accordance with its terms. Any claims on account of unsatisfactory goods or for other causes must be made to the merchant, thereby checking the return goods evil and the taking of discounts after the agreed time limit. Stated briefly, the use of trade acceptances insures to the seller a much stricter and more careful observance of the terms of sale by the customer.

2. *To the Buyer.* Under the method of open account selling the merchant has to set a higher sale price in order to recompense himself for loss from bad debts and for the time his money is tied up in credits granted to customers. The buyer who will agree to observe strictly his contract and make payment as agreed becomes in a very real sense a preferred buyer, to whom lower prices can be made. While retail merchants are customers of wholesalers, they are also sellers. What is an advantage to the wholesaler as a seller will be a similar advantage to the buying retailer when he in turn becomes a seller. The buyer will thus become more careful in his buying and will in turn be more careful of the credit risks he takes as a seller.

Bookkeeping Entries for the Trade Acceptance.—Since trade acceptances are drafts or bills of exchange, the entries for them are the same as explained above for the draft under the heads, “Drawer’s and Drawee’s Entries.” Since the payee in the case of a trade acceptance is always the drawer, it is not necessary to consider the bookkeeping record from his standpoint. Trade acceptances may be handled through the Notes Receivable account for the drawer and the Notes Payable account for the drawee. If, however, there are many such items and it is advisable to collect the information as to the different kinds of drafts, Trade Acceptances Receivable and Trade Acceptances Payable accounts may be set up. From the standpoint of their appearance on the balance sheet it makes a more favorable impression to classify drafts arising out of purchase and sale transactions separately from other drafts.

Other Types of Drafts.—Several other types of drafts should be mentioned.

Form 39. Bank Draft

THE PASSAIC TRUST AND SAFE DEPOSIT COMPANY
MEMBER OF THE FEDERAL RESERVE SYSTEM
PASSAIC, N. J. August 13 1921

No. 2379

PAY TO THE ORDER OF John Jaffe \$ 10 ⁷⁵/₁₀₀

THE SUM OF \$10 AND 00 Cts DOLLARS

TO THE FEDERAL RESERVE BANK
NEW YORK

ASST. TREASURER Wm. Schell

Form 39. Bank Draft

Form 40. Post-Office Money-Order

21834 New Rochelle, Sta. 3, N. Y. 31
OFFICE NUMBER SERIAL NUMBER

United States Postal Money Order
AUG 15 1921

THE POSTMASTER AT Bellevue, Montana

WILL PAY AMOUNT STATED ABOVE TO ORDER OF PAYEE NAMED IN ATTACHED COUPON OF SAME NUMBER. IF ISSUED WITHIN THE CONTINENTAL UNITED STATES, ALASKA EXCEPTED, THE POSTMASTER AT ANY MONEY ORDER OFFICE IN THE CONTINENTAL UNITED STATES, ALASKA EXCEPTED, WILL PAY IF PRESENTED WITHIN THIRTY DAYS FROM DATE OF ISSUE.

PAYEE: John Doe
RESIDENCE: Bellevue, Montana

REMITTER: John Doe

THIS MONEY ORDER IS NOT GOOD FOR MORE THAN LARGEST AMOUNT INDICATED ON LEFT-HAND MARGIN OF THE ORDER AND ANY ALTERATION OR ERASURE RENDERS IT VOID

Form 40. Post-Office Money-Order

Form 41. Express Money-Order

EXPRESS MONEY ORDER
A-0000000

WHEN COUNTERSIGNED BY AGENT AT POINT OF ISSUE

Pay on presentation to Smith Jones & Company or order

The Sum of twelve and 19/100 Dollars

Countersigned Andrew Campbell Agent

Issued at Banker State of Ill.

Date March 15 1921

NAME OF REMITTER Capital Bank

Form 41. Express Money-Order

1. *Bank Draft.* The **bank draft** (Form 39) is nothing more than a bank's check drawn on a deposit kept with another banker, usually in another place.

2. *Post-Office and Express Money-Orders.* The **post-office money-order** (Form 40) is a draft drawn by one postmaster on another and made payable to the party named. It permits the transfer of funds through the postal system of the country. The **express money-order** (Form 41) is a similar draft by one agent of the express company on another agent.

QUESTIONS

1. In what countries were drafts or bills of exchange used before England made use of them?
2. In what way did the conditions of travel, immediately following the "dark ages," stimulate the use of the draft or bill of exchange?
3. In what way is the Law Merchant connected with the draft?
4. What is the primary purpose of a draft?
5. What was the form of the early draft or request?
6. Name three classifications of drafts.
7. Which developed first, the foreign or the domestic drafts? Why?
8. Give an illustration of a foreign draft. Domestic.
9. Distinguish between time and sight drafts.
10. Give two divisions of time drafts.
11. Differentiate between bank drafts and commercial drafts.
12. (a) Name the parties to a commercial draft.
(b) What are the relations of the parties?
13. To be negotiable, what must a draft contain?
14. Describe the standard form of a draft.
15. (a) Give an illustration of a sight draft.
(b) A time draft after sight.
(c) A time draft after date.
16. (a) Compare a commercial draft with a check.
(b) With a promissory note.
17. Give the Negotiable Instruments Law definition of a draft or bill of exchange.
18. (a) What is meant by "accepting a draft"?
(b) What is the form of the acceptance?
(c) Which party accepts the draft?
(d) Where is the acceptance placed on a draft?

19. (a) May the party on whom a draft is drawn refuse to accept it? Why?
(b) How much time is given in which to decide?
20. If the drawee destroys or refuses to return a draft presented for acceptance, how will it affect his position?
21. (a) What is a general acceptance?
(b) Qualified acceptance?
22. How is the date of maturity of each of the following drafts found:
(a) Sight draft?
(b) Time-after-sight?
(c) Time-after-date?
23. (a) What is a collection draft.
(b) How does it differ from a three-party draft?
(c) Will banks accept them as deposits? Why?
24. Distinguish between an order and a straight bill of lading.
25. Explain fully the three methods of making C. O. D. collections.
26. What accounting record is made of C. O. D. transactions:
(a) In the case of the three methods explained in Question 25?
(b) In the case of local delivery?
27. (a) What is meant by "dishonored by non-acceptance"?
(b) What kind of drafts must be protested for non-acceptance?
28. (a) With which indorser on a promissory note does the drawer's liability correspond?
(b) Can the indorsers on a draft be held? How?
29. (a) Distinguish between protest for non-acceptance and protest for non-payment.
(b) Explain "No protest, tear this off before presenting" printed on the end of a draft.
30. (a) What is the drawer's entry at the time a sight draft is drawn, when the payee is a third party?
(b) Would your answer be the same if it were a time draft? Explain.
31. (a) What entry should the drawer of a collection draft make?
(b) Should the entry be made at the time the draft is drawn or when it is paid? Why?
32. What are the drawer's entries in case the draft is protested for non-acceptance?
33. If the draft is protested for non-payment at maturity, what entry should the drawer make?
34. What is the payee's entry for a sight draft? Time draft?

35. Are the payee's entries made at the time he receives the draft or when the draft is paid? Explain.
36. If the draft is protested for non-acceptance or non-payment, what are the payee's entries?
37. What is the drawee's entry—
- (a) At the time he honors a sight draft?
 - (b) At the time he accepts a time draft?
38. Give the drawee's entry at the time he pays his acceptance.
39. What is the purpose of the trade acceptance?
40. State the Federal Reserve Board's requirements in regard to trade acceptances.
41. Describe the form of the trade acceptance approved by—
- (a) The Federal Reserve Board.
 - (b) The American Acceptance Council.
42. Compare the trade acceptance and the commercial draft.
43. Give the definition of the trade acceptance.
44. Enumerate as many as you can of the disadvantages of the open account.
45. State the advantages of the trade acceptance—
- (a) To the seller.
 - (b) To the buyer.
46. Under what titles may the trade acceptance be recorded on the books of—
- (a) The seller of the goods?
 - (b) The buyer of the goods?
47. Name some other types of drafts.
48. What is the purpose of a bank draft?
49. Give the form of a bank draft.
50. What is meant by "New York exchange"? Explain.
51. In the case of a bank draft does the drawer assign his funds in the hands of the drawee? Explain.
52. Must the drawee of a bank draft honor it? Explain.
53. (a) What is a post-office money-order?
- (b) Compare with a bank draft.
 - (c) Under what conditions are they used?
54. (a) What is an express money-order?
- (b) Compare with a post-office money-order and bank draft.
 - (c) Under what conditions would the express money-order be more desirable than the drafts named in (b)?

55. (a) Can money be transferred by telegraph?
(b) Telephone?
(c) Registered mail?
(d) Express?
56. Explain the conditions under which each of the methods of transmitting money named in Question 55 would be used.

PROBLEMS

1. Manton and Company drew at sight on C. H. Thomas, Lansing, Mich., for \$476.40 on June 4, 19—, in favor of Clark, Jewell and Company, and remitted the draft to them in full of account. Thomas paid the draft June 17, 19—.

- (a) Write the draft.
- (b) Give the drawer's entry.
- (c) Give the payee's entry.
- (d) Give the drawee's entry.

2. Rice and Dixon, Omaha, Neb., owe you on account. In settlement they send you a 10-day sight draft for \$1,500, dated August 5, 19—, drawn on H. F. Osborn, 25 State St., Chicago, Ill. Osborn accepted the draft August 8, payable at the Dearborn National Bank.

- (a) Write the draft with the acceptance.
- (b) State the position occupied by each party to the draft. Give reasons.
- (c) Give Rice and Dixon's entry.
- (d) Give your entry.
- (e) Give H. F. Osborn's entry on August 8.

3. David E. Weller, 464 Woodward Ave., Detroit, Mich., agreed to honor your sight draft of May 26, for \$625.40, drawn in favor of yourself. Weller paid the draft May 31.

- (a) Write the draft.
- (b) Give your entry.
- (c) When will your entry be made? Explain.
- (d) Give Weller's entry. When will it be made?

4. On June 21, you drew a 60-day draft for \$750 on Luther Randall, 176 High St., Columbus, Ohio, for collection of his account. He accepted the draft June 26 and returned it to you.

- (a) Write the draft including acceptance.
- (b) Give your entry. When will it be made?
- (c) When will the draft be due?
- (d) Give Randall's entry at the date of acceptance.

5. July 31 you discounted the above described draft at the Western National Bank.

- (a) What indorsement would you place on the draft?
- (b) Give your entry at the date of discount.
- (c) Give the bank's entry at the date of discount.
- (d) Will you make an entry when Randall pays his acceptance at maturity? Why?

6. Your sight draft for \$250 on Watkins and Company, 317 Seneca St., Buffalo, N. Y., drawn for collection through the Union State Bank on May 16, was honored May 20.

- (a) Write the draft.
- (b) Give your entry. On what date will it be made?
- (c) Give Watkins and Company's entry.

7. Floyd C. Brewer, Jackson, Miss., telegraphed an order for merchandise to be shipped immediately with instructions that a sight draft with bill of lading attached be sent to the Planters Bank of Jackson. You filled the order, which amounted to \$876.45, and sent the draft as requested.

- (a) Explain the procedure in this transaction from the time the order is filled until the draft is paid.
- (b) If Brewer failed to honor the draft, what action would you take? Explain.
- (c) Write the draft.
- (d) Give your entries.
- (e) Give Brewer's entry.

8. Harrison and Company of Mobile, Ala., sold \$700 worth of merchandise to William Raymond of Nashville, Tenn., November 5, 19—, terms 90-day trade acceptance.

- (a) Write the trade acceptance using the form approved by the Federal Reserve Board.
- (b) Give Harrison and Company's entry at the time of sale.
- (c) Give William Raymond's entry at the time he honored the trade acceptance.
- (d) Give Harrison and Company's entry when the acceptance was paid.
- (e) Give Raymond's entry when he paid the acceptance.

9. A trial balance contains, among others, the following accounts:

Trade Acceptances Receivable.....	\$4,700 -
Trade Acceptances Payable.....	\$3,800 -

(a) State what each represents in terms of the fundamental accounting equation.

(b) How should each item be shown on the balance sheet?

10. October 23, 19—, you sold to Robert Hudson, Baltimore, Md., bill of merchandise, terms 60-day trade acceptance.

(a) Write the trade acceptance using the form approved by the American Acceptance Council.

(b) Give your entry when you received the acceptance.

(c) Give Hudson's entry when he honored the acceptance.

(d) Give Hudson's entry when he paid his acceptance.

(e) Give your entry on the date you received payment for the acceptance.

11. November 25, 19—, you bought of the First National Bank, H. B. Hazen, Cashier, by check, draft No. 13764, on the Hudson National Bank, New York City, for \$1,247.50, and sent it to Gibbs and Lewis, Providence, R. I., to close your account. Exchange on the draft \$1.25.

(a) Write the check you drew on the First National Bank to pay for the draft and exchange.

(b) Write the New York draft.

(c) Should this draft be indorsed? Why?

(d) Give your entry.

12. (a) Write a bank draft for \$500. Chicago exchange. Supply the other necessary data.

(b) Write the indorsement to transfer it to George H. Canfield.

(c) Write the check to pay for the draft, exchange 50 cents.

(d) Give the sender's entry.

(e) Give Canfield's entry.

13. You receive in the morning's mail:

Collection draft, 30-day sight, drawn on H. S. Harris, Omaha, Neb., for \$300 and accepted by him, January 10, 19—.

30-day trade acceptance accepted by Earl Benson, January 9, 19—, for \$125.30 payable at the Huron National Bank, Saginaw, Mich.

A bank draft for \$250, Detroit exchange, from Arthur Higgins to apply on account.

Post-office money-order for \$79.57 from H. D. Hubbard in payment for an order of merchandise inclosed with it.

J. M. Herbert's 60-day note for \$316.90 in settlement of his account. Give your entry for each item.

14. A series of transactions to be recorded in the bound blank books provided—a continuation of Problem 15, Chapter XXVI.

This concludes Mr. Thatcher's business transactions for the quarter ending March 31, 19—.

Record the following transactions in the books of original entry:

March, 19—

1. Sold to Roy A. Parks merchandise \$4,736.85, terms 30-day trade acceptance dated today. (Since you will receive the acceptance later, this transaction should be entered in the sales journal and charged to the customer's account.) Paid the Wright Construction Company by check for enlarging the store building, as per contract, \$2,500, and for repairing floors in the old part of the building \$117.
3. Gave H. M. Scott Company check in payment of our 60-day interest-bearing note of 1/2/—.
4. Drew at 30 days' sight on Amos K. McBride, Pittsburgh, Pa., for \$500 in favor of Herbert Murray, Nashville, Tenn., and remitted the draft to Murray to apply on account. Received from Roy A. Parks 30-day trade acceptance properly accepted, payable at the Western Trust Company, Omaha, Neb., dated March 1, 19—, for sale of that date \$4,736.85.
5. Received from Chester Pierce, St. Paul, Minn., merchandise shipped and invoiced on the 1st at \$4,573.75, terms 30-day trade acceptance. We accept the trade acceptance making it payable at the First National Bank.
6. Gave the First National Bank our check for \$2,000 in full payment of our 60-day note of 1/5/—.
8. Accepted, payable at the First National Bank, 20-day sight draft for \$350 dated March 6, 19—, drawn by Herbert Murray, Nashville, Tenn., in favor of Henry Townsend. Received check for \$132 from Amos K. McBride, in full of account. Sold to Roy A. Parks, 2/30, n/60, merchandise \$2,765.45. Sold merchandise to sundry customers for cash \$12,632.62.
10. Donated cash to the Y. M. C. A. \$10, and to the K. of C. \$10. Mrs. Thatcher's dressmaker presented an order for \$78.50 for personal services rendered to Mrs. Thatcher. We paid this order in cash. Gave H. M. Scott and Company, Denver, Colo., check for invoice #6, less discount.
11. Our bank notified us that Amos K. McBride's check of March 7, drawn on the Bank of Pittsburgh for \$132 had been returned marked "No Funds," and that the check had been charged

to our account. (To correct your cash book and show that you have a claim of this amount against McBride charge him for the check.)

13. Paid in cash: office salaries \$350; salesmen's salaries \$300. Amos K. McBride informs us that he is financially embarrassed at the present time but will make payment in the early part of next month. We inform him that we shall be glad to extend the time.
14. H. M. Scott and Company notified us that they had allowed \$17.70 on our disputed claim of \$40 for damaged goods on invoice of \$1,217.70, dated December 31, 19—. We accepted the allowance and sent them check for \$1,200 in full settlement of that invoice.
15. Gave Herbert Murray check in payment of our 60-day note of 1/14/—, \$1,500.
17. Received merchandise ordered from sundry creditors on the 13th and sent them 30-day trade acceptances duly accepted by us covering all purchases \$9,781.55.
19. Paid cash for general expenses \$48.70. Received check from Homer Welbrun for sale #7, less 2%.
20. Sold merchandise to sundry customers, terms 30-day trade acceptance \$7,844.25.
24. Received merchandise from H. M. Scott and Company, invoice dated March 21, 19—, \$3,227.30, terms 2/30, n/60. Received merchandise, invoice dated March 22, \$1,770.84, terms 3/30, n/60, from Chester Pierce.
25. Gave the Ezy Advertising Company check for various circulars and other advertising \$110.
28. Our bank notified us that it had paid and charged to our account our 20-day sight acceptance of 3/8/—, \$350, drawn by Herbert Murray.
31. Our bank notified us that it had placed to our credit 30-day trade acceptance of 3/1/—, in our favor, accepted by Roy A. Parks, \$4,736.85; and that it had paid and charged to our account 30-day trade acceptance, \$4,573.75, favor of Chester Pierce, accepted by us 3/1/—. Paid telephone and telegraph bills by check \$18.45. Gave —— Railroad check for freight \$303.28, of which \$192.75 applies to purchases, and \$110.53 applies to sales.

(a) Summarize the special journals and balance the cash book.

(b) Post and prepare a trial balance, recording it on pages 32 and 34

of the journal blank, heading the seventh and eighth columns, "March 31, 19—."

(c) Using the additional information given below:

1. On a sheet of journal paper prepare a balance sheet of March 31, 19—.
2. On a sheet of journal paper prepare a profit and loss statement for the 3 months ended March 31, 19—.

Additional Information March 31, 19—:

Merchandise inventory.....	\$8,791.50
Taxes accrued (estimated).....	92.40
Salesmen's salaries accrued.....	125 -
Office salaries accrued.....	90 -
Advertising deferred to the next period.....	78 -
Material on hand:	
General expense.....	\$30 -
Office supplies.....	18 -
Insurance unexpired.....	20 -
William H. Powell owes rent for the current month.....	60 -
Interest accrued on Liberty bonds.....	10 -
Interest accrued on mortgage payable.....	90 -

Provide for depreciation on the balance in each account as follows:

Furniture and fixtures, 1% per month
 Delivery equipment, 1½% per month
 Buildings, ½% per month

Note that this is a 3 months' period.

(d) Close the ledger by journal entries.

(e) Prepare a post-closing trial balance and record it in columns 9 and 10 of the trial balance section.

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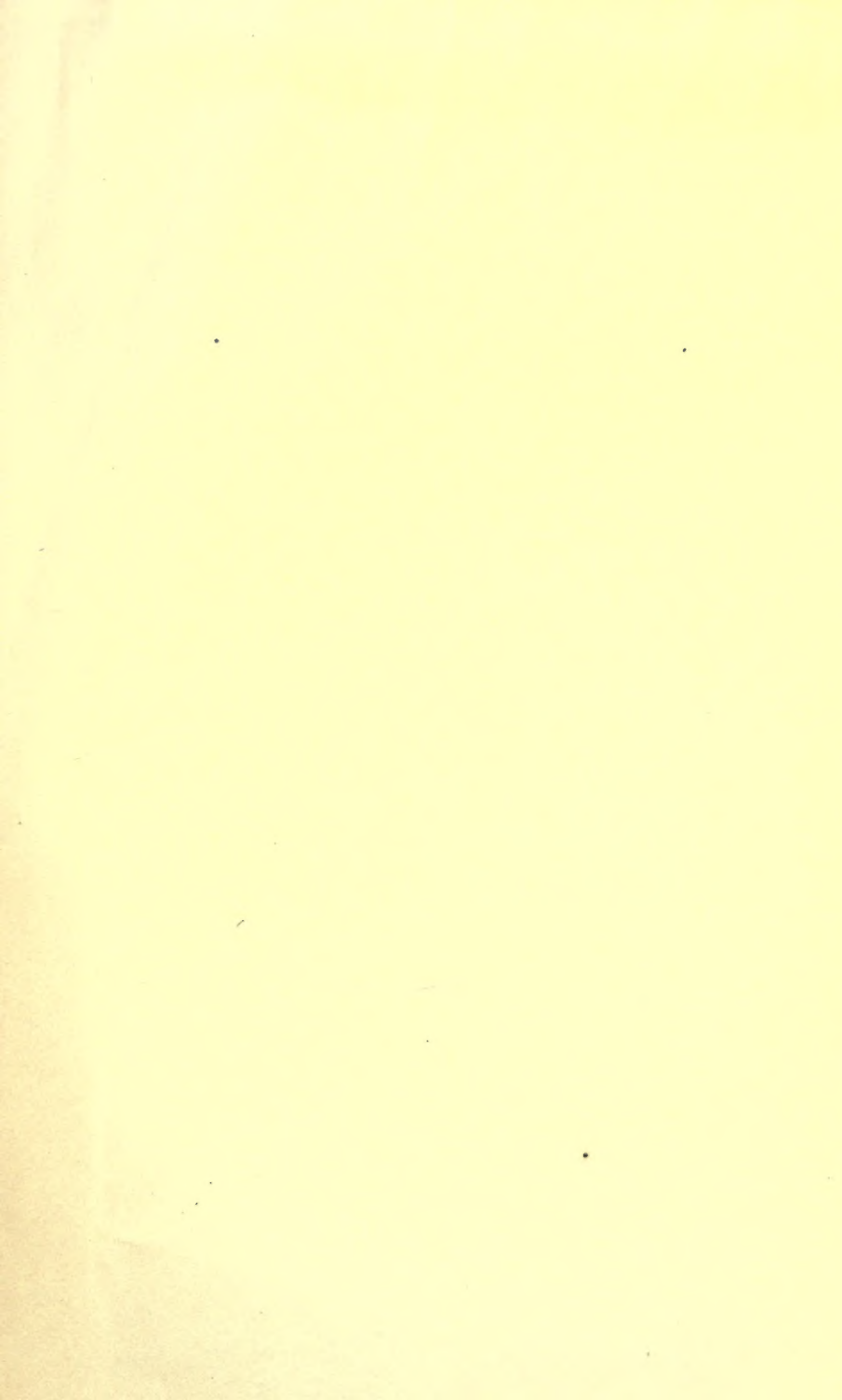
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